85-1250

No. _____

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

TRUNKLINE GAS COMPANY

and

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

RAYMOND N. SHIBLEY *
PATRICK J. WHITTLE
LEBOEUF, LAMB, LEIBY & MACRAE
1333 New Hampshire Ave., N.W.
Washington, D.C. 20036
(202) 457-7500
Attorneys for Petitioners

January 23, 1986

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Whether the Natural Gas Act, 15 U.S.C. §§ 717-717w, and the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432, administered from their inception as applying public utility service obligation and rate-making standards to natural gas pipelines, may be re-interpreted validly to require pipelines to engage in head-to-head price competition for service to their previously certificated markets.

2. A. Whether the due process requirements of the Fifth Amendment to the Constitution were violated by the squeeze applied by the Commission's elimination of the operative minimum bill and minimum take provisions of pipeline sales contracts with their customers, in conjunction with its refusal to modify similarly the equivalent obligations in the pipeline purchase contracts with producers.

B. Whether these same requirements were not violated by the Commission's attempt to force all pipelines' sales rates to a single level when some pipelines' costs are much higher than others' as a direct result of the multi-tiered wellhead rate structure mandated by the NGPA.

LIST OF PARTIES

The parties to the proceeding in the Court of Appeals are as follows:

Algonquin Gas Transmission Corporation
ANR Pipeline Company
Arkansas Louisiana Gas Company,
a Division of Arkla, Inc.
Cascade Natural Gas Corporation
City Gas Company
Great Lakes Gas Transmission Company
Madison Gas & Electric Company
MIGC, Inc.
Midwestern Gas Transmission Company
Northwest Natural Gas Company
Pacific Interstate Offshore Company
Tennessee Gas Pipeline Company
Texas Eastern Transmission Company
Texas Gas Transmission Company
Transcontinental Gas Pipeline Corporation
Washington Natural Gas Company
Wisconsin Fuel & Light Company
Wisconsin Gas Company
Wisconsin Natural Gas Company
Wisconsin Power & Light Company
Wisconsin Public Service Commission
Aluminum Association
American Iron and Steel Institute
Association of Businesses Advocating Tariff Equity:

Abitibi-Price Corporation
BASF Wyandotte Corporation
The Budd Company
Bundy Corporation
Chrysler Corporation
Clark Equipment Company
Detroit Strip Division of Cyclops Corporation
Dow Chemical U.S.A.
Dundee Cement Company

Eaton Corporation
Edward C. Levy Company
Escanaba Paper Company
Ford Motor Company
General Motors Corporation
Great Lakes Steel Division of
National Steel Corporation
Haworth Manufacturing, Inc.
Hayes-Albion Corporation
Huron Valley Steel Corporation
James River Corporation
Kastle Steel Corporation
Marblehead Lime Company
McLouth Steel Corporation
Menominee Paper Company
Michigan Sugar Company
Monsanto Company
Mueller Brass Company
National Standard Company
Pennwalt Corporation
Quanex Corporation.
Steelcase Inc.
TRW
Wolverine Aluminum Corporation

Brooklyn Union Gas Company
Consolidated Gas Transmission Corporation
Consumers Power Company
El Paso Natural Gas Company
Foothills Pipeline (Yukon) Ltd. and
Pan-Alberta Gas Ltd.
Georgia Industrial Gas Group:

American Industrial Clay Company
of Sandersville
Anglo-American Clays Corporation
Burgess Pigment Company
Engelhard Corporation
Mineral & Chemicals Division, Nabisco, Inc.

Nord Kaolin Company
Thiele Kaolin Company

Inter-City Gas Corporation
Michigan Consolidated Gas Company
Michigan Gas Utilities Company
Natural Gas Pipeline Company of America
Northern Illinois Gas Company
Peoples Gas Light and Coke Company
Process Gas Consumers Group:

American Can Company
American Standard Inc.
Armco Inc.
Bethlehem Steel Corporation
Borg-Warner Corporation
Cone Mills Corporation
Corning Glass Works
General Motors Corporation
Owens-Corning Fiberglass Corporation
Owens-Illinois, Inc.

Public Service Commission of the State of New York
Public Utilities Commission of the State of California
State Corporation Commission for the State of Kansas
Chattanooga Gas Company, a Division of Jupiter Industries, Inc.
Colorado Interstate Gas Company
Columbia Gas Transmission Corporation
Kansas State Corporation Commission
Northwest Energy Company
Pacific Gas and Electric Company
Pacific Gas Transmission Company
Pacific Interstate Offshore Company and Pacific Offshore Pipeline Company
Public Service Electric and Gas Company
Southern California Gas Company and Pacific Lighting Gas Supply Company

State of Michigan and
Michigan Public Service Commission
TransCanada Pipelines Limited
Washington Gas Light Company

The following listed companies are subsidiaries or affiliates of Panhandle Eastern Pipe Line Company and/or Trunkline Gas Company, petitioners herein:

Anadarko Production Company
Aurora Industries, Inc.
Century Refining Company
Dixilyn-Field Drilling Company
Energy Pipelines International Company
Faskure Technology, Inc.
Illinois Napgas Company
Mantaray Pipeline Company
Matagorda Island Development Corporation
Matagorda Island Exploration Corporation
Pan Alaska Gas Company
Pan Border Gas Company
Pan Eastern Coal Company
Pan Eastern Exploration Company
Pan Gas Storage Company
Panhandle Canadian Gas, Limited
Panhandle Eastern Corporation
Panhandle Eastern Pipe Line Company
Panhandle Trading Company
Panhandle Western Gas Company
PanMark Gas Company
Pelmar Company
Southwest Gas Storage Corporation
Stingray Pipeline Company
Trunkline Gas Company
Trunkline LNG Company
Trunkline Offshore Company
Wycoalgas, Inc.
The Youghiogheny and Ohio Coal Company

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FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Trunkline Gas Company and Panhandle Eastern Pipe Line Company hereby petition for a writ of certiorari for review of the decision of the Court of Appeals for the District of Columbia Circuit in *Wisconsin Gas Co. v. Federal Energy Regulatory Commission*, No. 84-1358, *et al.* (D.C. Cir. August 20, 1985).

OPINIONS BELOW

The decision of the Court of Appeals is reported at 770 F.2d 1144 and appears at Pet. App. A.[1] The Court of

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[1] References to "Pet. App. ——" appearing herein are to the Appendix to the Petition for Writ of Certiorari to the United

Appeals' orders denying rehearing and denying rehearing *en banc*, both dated October 25, 1985, are not officially reported and appear at Pet. Apps. B and C, respectively. The orders of the Federal Energy Regulatory Commission which were affirmed in part by the Court of Appeals, and are the subject of this petition, are: (a) Order No. 380, reported at 27 FERC (CCH) ¶ 61,318, and appearing at Pet. App. D; and (b) Order No. 380-A, reported at 28 FERC (CCH) ¶ 61,175, and appearing at Pet. App. E.

JURISDICTION

The decision of the Court of Appeals and its judgment in this case were entered August 20, 1985. A timely petition for rehearing and suggestion for rehearing *en banc* were denied by orders entered on October 25, 1985. This Court has jurisdiction to review the decision below under 15 U.S.C. § 717r(b) and 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The Fifth Amendment to the United States Constitution provides: "No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." Statutory provisions at issue herein include Sections 5(a) and 7(c) of the Natural Gas Act, 15 U.S.C. §§ 717d(a) and 717f(c), reproduced at Pet. App. I; Sections 4(a) and 4(e) of the Natural Gas Act, 15 U.S.C. §§ 717c(a), (e), reproduced at Trunkline/Panhandle App. A; and Section 601 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3431, reproduced at Trunkline/Panhandle App. B.

States Court of Appeals for the District of Columbia Circuit filed January 21, 1986 in *Transwestern Pipeline Co. v. Federal Energy Regulatory Commission*, No. 85-1219, in which Transwestern Pipeline Company is seeking certiorari of the Court of Appeals judgment which is also the subject of the instant petition. Two additional appendices, Trunkline/Panhandle Appendices A and B are attached hereto. Finally, references herein to "J.A. ——" are to the Joint Appendix filed by the parties in the Court of Appeals proceeding.

STATEMENT OF THE CASE

Under the Natural Gas Act and the Natural Gas Policy Act of 1978, the natural gas pipeline industry has been regulated as a public utility, with pipeline construction, operation and rates subject to Federal Energy Regulatory Commission regulation, to ensure efficiency and to prevent wasteful competition for core markets. Under that regime, and under the multi-tiered wellhead pricing provisions of the NGPA, pipelines have arrived at divergent individualized cost recovery needs. Commission Orders No. 380 and 380-A, affirmed by the Court of Appeals and under review herein, have restructured long-standing pipeline minimum bill provisions in a manner intended to throw pipelines open to unbridled head-to-head competition and to force the gas cost component of all pipeline rates down to a single, lowest-common-denominator level.

A. Historical Background

Trunkline Gas Company (Trunkline) and Panhandle Eastern Pipe Line Company (Panhandle), petitioners herein, are major interstate natural gas pipelines, subject to the regulatory jurisdiction of the Federal Energy Regulatory Commission (Commission) under the Natural Gas Act (NGA), 15 U.S.C. §§ 717-717w and the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432. As such, and like other major natural gas pipelines, they operate capital plants with aggregate investments amounting to many hundreds of millions of dollars, facilities constructed and operated under certificate authority granted by the Commission (and its predecessor, the Federal Power Commission (FPC)), pursuant to the requirements of Section 7 of the NGA, 15 U.S.C. § 717f. As sellers of natural gas, both Trunkline and Panhandle have public utility obligations to provide to their customers, on demand, a maximum quantity of natural gas specified in their service agreements with customers (the "contract quantity").

Because of pipelines' need to recover enormous capital investments and to acquire long-term gas supplies, this Court has long recognized that competition between pipelines must of necessity be somewhat limited: once a pipeline is certificated by the Commission to serve particular customers' needs, that portion of the market is committed during the contractual term in the absence of significant changes in conditions, though other pipelines are free to compete for incremental markets, subject to Commission review for compliance with its standards of public convenience and necessity. *See, e.g., United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 659-60 (1964). This has been the structure of the industry since the passage of the NGA. Consistent therewith, the NGA does not contemplate that a pipeline's natural gas resale rates be set by the marketplace; instead, it requires that such rates be set at a "just and reasonable" level, by the pipeline in the first instance, subject to Commission adjustment if necessary under the "utility-type ratemaking" standards of the Act. 15 U.S.C. §§ 717c, 717d (1982); *see Transcontinental Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, U.S. No. 84-1076, slip op. at 10 (January 22, 1986).

In order to ensure that they have sufficient gas supplies to meet their sales obligations, Trunkline, Panhandle and other interstate pipelines have made long-term contracts for the purchase of large quantities of natural gas from producers and other suppliers. While these contracts typically give Trunkline and Panhandle some flexibility in the amount and timing of their takes, the pipelines have agreed to take (or pay for) certain minimum quantities of gas on a periodic basis. In return for these "take-or-pay" provisions—which, in effect, require the pipelines to purchase minimum amounts of the gas committed to them—producers have consented to long-term dedications of gas reserves to Trunkline and Panhandle. J.A. 1249-54. These long-term contracts, with take-or-pay provisions, are "standard industry-wide." *Transcontinental Pipe Line Corp.*, U.S. No. 84-1076, slip op. at 13, 15.

Until the actions on which review is sought herein, the Commission (and the FPC before it) recognized that a similar exchange of commitments was just and reasonable as between a pipeline and its customers. Thus, under its authority to regulate rates and charges under Sections 4 and 5 of the NGA, 15 U.S.C. §§ 717c, 717d, the Commission regularly approved "minimum commodity bill" provisions in pipeline service agreements and tariffs for the pipeline's "partial requirements" customers —which account for 95 per cent of Trunkline's system sales and 60 per cent of Panhandle's. J.A. 1252-53.[2] Under these provisions, in exchange for the pipeline's commitment to sell it gas, a customer's bill would be calculated for each relevant period as though the customer had purchased a specified minimum amount of gas —in economic effect, inducing the customer to purchase that minimum amount. The purchase commitment thus assumed by the customer was not equal to the entire sales commitment of the pipeline, as it would typically be in an ordinary commercial sales contract. Instead, the customer's minimum bill specifies a lesser percentage of that quantity—75 per cent in the cases of Trunkline and Panhandle. J.A. 1251-52.

As the natural gas shortage of the mid-1970s developed, it became apparent that the traditional NGA regime of closely regulated—and artificially depressed—wellhead prices was not working adequately to spur suffi-

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[2] "Partial requirements" customers are, as the term implies, those customers which take only a *part* of their requirements from the pipeline in question, typically purchasing the remainder of their requirements from a second pipeline. Historically, the partial requirements customer (whether a utility or another pipeline) would have contracts with each pipeline selling to it, specifying the volume or percentage that would constitute the minimum take obligation. A pipeline's "full requirements" customers—those who purchase all their gas requirements from the pipeline—are typically not subject to minimum commodity bill provisions, since their purchases will always be equal to the full amount of their requirements. Pet. App. A at A-19.

cient production to meet the country's gas needs. The legislative response was the passage in 1978 of the NGPA. Therein, Congress established a system of incentive pricing for gas sold at the wellhead, dividing gas into a number of categories. Within the "new" categories of gas—*i.e.*, those wells which, prior to the passage of the Act, were not dedicated to the interstate market—the prices permitted to be charged by producers for first-sales were to rise gradually through a several-year transition period and ultimately to be deregulated, thereby spurring the needed new production. "Old" gas—that coming from wells completed and dedicated to interstate commerce before the passage of the NGPA—was to remain much lower in price than new gas and was to remain forever regulated. *Public Service Commission of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983); 15 U.S.C. §§ 3301-3432. Unlike wellhead prices, the sales rates which pipelines are permitted to charge remained subject to Commission regulation under Sections 4 and 5 of the NGA. 15 U.S.C. §§ 717c, 717d. In order to ensure that the producer incentives established by the NGPA were not indirectly stymied by Commission rate regulation of pipelines, however, Congress provided in the NGPA that, absent a showing of fraud, abuse or similar grounds, pipelines are entitled automatically to pass through to their customers any costs of purchased gas paid to first sellers which are within the NGPA price ceilings. 15 U.S.C. § 3431(b), (c).

The NGPA had two fundamental effects on the natural gas industry. First, it did indeed spur production as intended—so much so that the result was, as the Commission has been at pains to point out, a gas surplus presently existing. Pet. App. D at A-79 to A-80. Second, however, the NGPA created a permanent and highly artificial inequality between various pipelines' costs of service. Those pipelines which happened to have acquired large quantities of old gas in proportion to their total

needs had a very low average cost of purchased gas when compared to other pipelines—such as Trunkline—with a higher proportion of new gas, because old gas first-sale prices were artifically constrained to a level as little as one-third or less of those of most new gas.

Trunkline's vulnerability is particularly exacerbated by the fact that virtually all its customers are partial requirements customers whose alternative suppliers have a significantly lower-cost gas mix than Trunkline, due in large part to those suppliers' higher reserves of old gas. This disparity in cost results from Trunkline's great diligence in embracing the goals of the NGPA by engaging in a number of new gas supply projects—including purchases of additional higher-cost domestic gas as well as imported liquefied natural gas (LNG) from a new facility approved by the Commission as being in the public convenience and necessity. J.A. 1256-57. Similar conditions exist in the case of Panhandle. In its rulemaking under review herein, the Commission did not address how a pipeline in Trunkline's or Panhandle's position can possibly be expected to engage in head-to-head price competition with other pipelines while under such an innate disadvantage.

B. The Commission's Rulemaking

In August 1983, the Commission issued a Notice of Proposed Rulemaking in which, for the first time, it proposed to dramatically reduce the level and effectiveness of minimum bill provisions by removing all of a pipeline's variable costs—including, most importantly, its cost of purchased gas—from recovery in such bills. The Commission's stated concern was that pipelines might recover a windfall through minimum bills if they charged their customers for gas not actually taken. *Elimination Of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions,* 48 Fed. Reg. 39,238 (1983).

Substantial evidence was introduced before the Commission demonstrating that no such problem existed because customers of pipelines fulfilled their commitments by physically taking at least the minimum bill amounts of gas, which was the objective of the minimum bill provisions. J.A. 1252, 1522-23. Nonetheless, the Commission prescribed and is enforcing a new rule that eliminates all costs of purchased gas from existing minimum bill coverage and prohibits variable costs of any kind from being recovered via minimum bills in future tariff filings. *Elimination Of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions (Order No. 380)*, 27 FERC (CCH) ¶ 61,318 (1984); Pet. App. D. The Commission concluded that such minimum bills were "anti-competitive" in that they discouraged a pipeline's customers from reducing or ceasing purchases from the pipeline in order to purchase from a source (generally speaking, a second pipeline) offering a lower price. The Commission did not distinguish this effect from the identical deterrent effect of ordinary commercial purchase contracts. The Commission also failed to reconcile this result—which contemplated direct price competition between pipelines for core, certificated markets—with previous cases under the NGA, which held that inter-pipeline competition is for incremental markets, not for previously certificated markets.

C. The Decision of the Court of Appeals

Timely petitions for Commission rehearing having been denied in most respects,[3] Trunkline, Panhandle and approximately fifteen other parties petitioned the United

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[3] *Elimination Of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions (Order No. 380-A)*, 28 FERC (CCH) ¶ 61,175 (1984); Pet. App. E. The Commission also issued a number of subsequent orders in the proceedings, but Trunkline and Panhandle have not sought review of those orders before the Court of Appeals. *See* 29 FERC (CCH) ¶ 61,077 and 29 FERC (CCH) ¶ 61,332 (1984).

States Court of Appeals for the District of Columbia Circuit for review of the Commission's order and of the denial of rehearing, pursuant to that court's jurisdiction under 15 U.S.C. § 717r(b). The Court of Appeals affirmed, *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985); Pet. App. A, finding that "each of the order's essential elements is supported by substantial evidence" and that "the Commission has given reasoned consideration to each of the pertinent factors." Pet. App. A at A-42. The court remanded the orders of the Commission in one respect, holding that the Commission erred when it provided that fixed charges levied in the minimum bill by one pipeline on a "downstream" pipeline could not be passed along as fixed costs by the downstream pipeline. Pet. App. A at A-46 to A-50.

REASONS FOR GRANTING THE WRIT

The Commission's sudden rearrangement of long-settled sales arrangements in the natural gas industry violates the public utility standards upon which the NGA was founded—a market structure firmly entrenched by years of practice thereunder and by established court precedent. *See United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 659-60 (1964); *Transcontinental Pipe Line Corp.*, U.S. No. 84-1076, slip op. at 10. Moreover, the Commission's action was taken entirely without regard for its effects on the disparate cost-recovery requirements and competitive positions of individual pipelines—disparities caused by the policies of the NGPA. The Commission has no authority under present statutes to make these basic changes in the industry, and the Commission's action is therefore unlawful absent further legislative command.

The practical result of the Commission's disregard for the policies of its two governing statutes is to entirely deny pipelines such as Trunkline and Panhandle a fair opportunity to recover their costs. Coupled with their continuing public utility obligations, this amounts to a con-

fiscation of their property without due process of law and without just compensation, in violation of fundamental principles of public utility ratemaking which are based on the Fifth Amendment to the Constitution. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942); *West Ohio Gas Co. v. Public Utilities Commission of Ohio*, 294 U.S. 63 (1935). This action also necessarily results in a rate which is not "just and reasonable" as required by Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. §§ 717c, 717d. *FPC v. Hope Natural Gas Co.*, 320 U.S. at 603.

I. The Commission's Orders Attempt To Impose Head-To-Head Competition On The Natural Gas Pipeline Industry, In Violation Of The Public Utility Standards Of The Natural Gas Act And The Natural Gas Policy Act Of 1978.

The Commission's action on which certiorari is sought was premised on opening pipelines' core sales markets to direct head-to-head price competition—a policy antithetical to the closely regulated market structure established by the NGA. This Court has made clear the nature of the gas pipeline industry as governed by the NGA:

> This is not a field where merchants are in a continuous daily struggle to hold old customers and to win new ones over from their rivals. In this regulated industry a natural gas company . . . must compete for, enter into, and then obtain Commission approval of sale contracts in advance of constructing the pipeline facilities. In the natural gas industry pipelines are very expensive; and to be justified they need long-term contracts for sale of the gas that will travel them. . . . Once the Commission grants authorization to construct facilities or to transport gas in interstate commerce, once the distributing contracts are made, a particular market is withdrawn

> from competition. *The competition then is for the new increments of demand that may emerge with an expanding population and with an expanding industrial or household use of gas.*

United States v. El Paso Natural Gas Co., 376 U.S. at 659-60 (emphasis in original).[4] *See also Northern Natural Gas Co. v. FPC*, 399 F.2d 953 (D.C. Cir. 1968); *Panhandle Eastern Pipe Line Co. v. FPC*, 169 F.2d 881 (D.C. Cir.), *cert. denied*, 335 U.S. 854 (1948).

The Court's conclusion that the market structure established by the NGA foreclosed unbridled competition among pipelines is borne out by the Act's legislative history. When the Act was amended in 1942 to require Federal Power Commission certification for any pipeline construction or operation of facilities, the responsible House Committee described the purpose of this change:

> Section 7(c), as at present in force, regulates competition in the public interest by preventing uneconomic extensions and allowing those extensions which are in the public interest and in accord with the policy of the statute; but it so regulates only in case of extensions to "a market in which natural gas is already being served by another natural-gas company." *The present section consequently allows unregulated competition in extensions and even economic waste in the construction of new interstate natural gas pipe lines*, by natural gas companies subject to the Natural Gas Act in all other cases. Such a natural gas pipe line, as soon as it is constructed, it should be noted, comes within the Commission's jurisdiction and is subject to regulation as a facility used for the transportation of natural gas in interstate commerce. Obviously adequate regulation of such pipe lines when con-

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[4] The Court's description was not a mere statement of fact—it was intended to delineate the nature of "competition" within the industry, for purposes of applying the *legal* standard of probability of harm to competition under Section 7 of the Clayton Act, 15 U.S.C. § 18.

> structed requires that the Commission also have jurisdiction to regulate construction and initial financing. By the unregulated construction of a pipe line, uneconomic construction, or inflated costs may make proper regulation of operation thereafter difficult or practically impossible. The bill when enacted will have the effect of giving the Commission an opportunity to scrutinize the financial set-up, the adequacy of the gas reserves, the feasibility and adequacy of the proposed services, and the characteristics of the rate structure in connection with the proposed construction or extension at a time when such vital matters can readily be modified as the public interest may demand.

H.R. Rep. No. 1290, 77th Cong., 1st Sess. 2-3 (1941) (emphasis added). As noted, even the originally-enacted version of the NGA required that a certificate be obtained prior to entering "a market . . . already being served by another natural-gas company," contemplating close regulatory control over inter-pipeline competition. Moreover, Section 7(c) was expressly intended, in part, to prevent "cutthroat" competition by ensuring that, in certificating multi-pipeline markets, due consideration would be given by the Commission to the sufficiency of each pipeline's reserves to provide adequate service in the long-term, and that the Commission *not* merely approve the provision of lower rates of a transient nature. 84 Cong. Rec. 9101 (1938). In short, the intent of Section 7(c) was to prevent "wasteful" competition by strictly regulating the extent to which pipelines could build and operate facilities in competition with each other.

As a part of its mandate under the NGA, the Commission is also called upon to ensure that "just and reasonable" rates are charged by pipelines. 15 U.S.C. §§ 717c, 717d. But this does not mean, as the Commission would have it, using the marketplace to force a pipeline to charge a rate equal to the lowest rate charged by any other pipeline in its market area. First, the concept of

"just and reasonable" rates requires a *balance* between the pipeline's financial health and the consumers' interests, not merely a reflexive setting of the lowest price conceivable. *See, e.g., FPC v. Memphis Light, Gas & Water Division*, 411 U.S. 458, 465-66, 474 (1973); *FPC v. Hope Natural Gas Co.*, 320 U.S. at 603, 610. Second, it is legal error to presume, as the Commission does here, that whatever price is forced on a pipeline by its competitors is just and reasonable for NGA purposes; this Court has flatly rejected previous Commission reliance on the marketplace to set just and reasonable rates. *See FPC v. Texaco, Inc.*, 417 U.S. 380, 397-99 (1974).

Nor has the statutory policy of the NGA as to the limits on inter-pipeline competition been changed in any way by the passage of the NGPA in 1978, which patently applies only to gas production sales, not to pipeline sales, which remain fully regulated under the NGA. Even as to the wellhead market, the Commission's view in Order No. 380 that the policy of the NGPA was to mandate an "increasingly competitive wellhead market [with] an opportunity for gas prices to increase or decrease—whichever the market demands" (Pet. App. D at A-88) is not supported by the legislative history. Rather, Congress intended for prices to *rise* gradually to a level no longer subject to regulation in order to spur new gas production. Thus, in the House Report on the bill which became the NGPA, the Committee on Interstate and Foreign Commerce stated: "[the new] pricing policy must recognize the costs and risks associated with finding new supplies of natural gas and provide positive price incentives to encourage expanded exploration for, and development of, our Nation's valuable domestic natural gas resources." H.R. Rep. No. 95-496, Part 4, 95th Cong., 1st Sess., 101 (1977). This Court, too, has recognized that the legislative purpose of the NGPA was to provide incentives for gas production by permitting wellhead prices to *rise*. *See*

Public Service Commission of New York v. Mid-Louisiana Gas Co., 463 U.S. 319 (1983); *Transcontinental Pipe Line Corp.*, U.S. 84-1076, slip op. (dissent) at 7-8.

In short, the NGPA was intended to drive *producer* prices *up*; the Commission's belief that it supports regulatory action designed to drive pipeline prices *down* is therefore perverse. But it is more than that—it is contrary to the express mechanism of NGPA Section 601 (b) and (c), 15 U.S.C. § 3431(b), (c), which guarantees interstate pipelines the right, absent fraud, abuse or similar grounds, to pass through to their customers the costs of purchasing gas in first sales if those costs do not violate the NGPA ceilings or are not subject to any ceiling. That section plainly contemplates that the Commission may not use its power to regulate the sales rates of pipelines to impose an indirect regulatory impact on the wellhead market.[5] Yet it was the Commission's express intent herein to exert downward pressure on wellhead prices via the mechanism of regulating pipelines (Pet. App. D at A-87, A-100)—a result plainly contrary to the purpose of Section 601.

The Commission's assertion that its action is justified because of changes in the marketplace since the passage of the NGPA is plainly erroneous. Throughout the history of the gas industry it is apparent that in every instance in which more than one pipeline serves a cus-

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[5] Even before the passage of the NGPA, such indirect regulation of producer prices by the mechanism of imposing controls on pipelines' recovery of gas costs was accepted by this Court only in the context of a regulatory "experiment" subject to "close review" by the FPC, and only if the FPC took pains to ensure that pipelines did not run an unfair "risk of incurring unrefundable expenses that may later be disallowed." *FPC v. Texaco, Inc.*, 417 U.S. at 392-93. Unlike the *Texaco* case, the Commission here has—entirely without a period of experimentation—imposed a new indirect regulatory regime on all pipelines for all time. And the "risk" of pipelines' being unable to recover their previously incurred costs is in many cases a virtual certainty.

tomer or a region, disparate prices would exist; in fact, the reason for prescribing minimum bill provisions in partial requirements contracts and tariffs was to prevent displacement of certificated suppliers, even though higher priced than other available sources. Pet. App. D at A-79 to A-81, A-94. To convert a public utility standard of regulation into a competitive price struggle is a drastic change that is inconsistent with the framework established by the NGA and NGPA. Such fundamental changes require legislation and are well beyond the scope of the Commission's rulemaking power. *See FPC v. Texaco, Inc.*, 417 U.S. at 400.[6]

II. The Commission's Actions Are Unlawfully Confiscatory Because They Deny Pipelines Their Customers' Purchase Commitments Without Relieving Pipelines Of Their Own Purchase Commitments, And Because They Deny Pipelines The Right To Recover Their Costs Under The Two-Tiered Structure Of The NGPA.

The Commission's orders, contrary to the policies of the NGA and NGPA, have created a variety of serious eco-

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[6] The regulatory structure of the NGA was based in large part on the model previously established by the Interstate Commerce Act and the Motor Carrier Act, 49 U.S.C. §§ 1, 306-08. *See* H.R. Rep. No. 709, 75th Cong., 1st Sess. 6 (1937). While the industries subject to those acts have been subjected to increasing head-to-head competition in recent years, this has been accomplished only by the passage of new legislation entirely revamping the statutory structure of the acts. *See, e.g.*, Pub. L. No. 95-473, 92 Stat. 1466 (1978). This history is further evidence that the Commission's attempt to recast in a similar fashion the parallel regulation of the natural gas industry can be accomplished only by Congressional action.

It may be noted that more recently, in proceedings still undergoing Court of Appeals review, the Commission embarked still further on its restructuring of the gas pipeline industry by prescribing common carrier transportation requirements for pipelines that transport *and* simultaneously permitting pipeline sales customers to reduce or eliminate their contract quantities. *See Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol (Order No. 436)*, 49 Fed. Reg. 42,408 (1985); *see also* note 7, *infra*.

nomic problems for pipelines amounting to forbidden confiscation in many cases. In the case of Trunkline—virtually all of whose certificated customers have other pipeline suppliers—the effect of the rule is confiscatory because it penalizes Trunkline for its Commission-sanctioned attempts to aggressively develop new gas supply services in direct pursuance of the policy of the NGPA. To replenish its gas supplies in order to serve certificated markets, Trunkline invested many millions of dollars in a number of gas supply areas, and agreed to take-or-pay clauses with its suppliers in exchange for assurances that gas would be available. Moreover, as a result of Trunkline's energetic gas acquisition programs, Trunkline's gas supply became heavily weighted toward new gas. Because of the NGPA's provisions for high incentive-pricing for new gas coupled with the Commission's continuing regulation of old gas prices at relatively low levels, these acquisitions resulted in Trunkline having a more expensive overall gas supply mix than many other pipelines.

As noted, Trunkline's aggressive gas acquisition practices were made possible *only* by the fact that its sales were certificated by the Commission with tariff provisions anchored by minimum commodity bills. Some 95 per cent of Trunkline's system sales are to partial requirements customers that have other suppliers. J.A. 1253. Before taking steps which would both commit huge amounts of funds to take-or-pay arrangements with suppliers and would unavoidably require the cost of Trunkline's gas supply mix to rise, Trunkline and also Panhandle had Commission-approved contractual assurances that their customers—for whose benefit those programs were undertaken—would not desert them when industry supply and demand balances were restored. The minimum commodity bill tariff provisions—incorporated in Trunkline's *contracts* with its customers—provided these assurances. Similar considerations apply to Panhandle, Trunkline's largest customer, which makes 60 per cent of its system sales to partial requirements customers. *Id.* The action

taken by the Commission has now virtually destroyed Trunkline's and Panhandle's property interest in these contracts.

Moreover, the Commission's attempt to force all pipeline rates to a single, lowest level is confiscatory because it ignores the intrinsically higher costs imposed on many pipelines under the two-tiered NGPA. In the new, theoretically "pure" pipeline competition envisioned by the Commission's order, Trunkline and Panhandle, as well as other pipelines, have become victims of their own diligence in pursuing the goals of the NGPA. Fair inter-pipeline competition is a chimera because the burden of relatively expensive new gas in the supply mix can be avoided only at the equaliy burdensome cost of massive take-or-pay exposure to the producers. In Trunkline's case, this exposure now exceeds $1 billion. Thus, Trunkline faces the dilemma of lowering prices to a level below its costs or losing much or most of its gas sales market, at the risk of not recovering its take-or-pay and other costs. As a result, Trunkline's very viability as a continuing entity is threatened. And in this context, the theoretical competitive benefits cited by the Commission are without weight—as this Court has made clear, in determining whether Commission rate orders are just and reasonable, "[i]t is not theory but the impact of the rate order which counts." *FPC v. Hope Natural Gas Co.*, 320 U.S. at 602. *Accord, Electricity Consumers Resource Council v. FERC*, 747 F.2d 1511, 1514 (D.C. Cir. 1984).[7]

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[7] To ameliorate this confiscatory effect, the Commission might have taken action within its power to eliminate the NGPA-fostered competitive disparity—for instance, by taking steps to relieve Trunkline, Panhandle and similarly situated pipelines of their heavy take-or-pay burdens within the Commission's remaining jurisdiction over many gas first-sales contracts. Indeed, such a step seems obvious, since by the Commission's own reasoning, take-or-pay clauses are "anti-competitive" and may lead to windfalls to producers. Moreover, such a step would be far more precisely tailored to the Commission's stated objective of communicating price signals to producers. But the Commission declined to do so, denying that any

In this context, the Commission's action results in a rate structure so prejudicial to Trunkline's ability to recover its costs as to be confiscatory and therefore unlawful. As the Court of Appeals for the Tenth Circuit said in a similar context:

> We cannot condone Commission action which, on the one hand, allows producer price increases to pipeline companies, and, on the other hand, denies the pipeline companies a return on the investments they necessarily incur in serving their customers while simultaneously incurring the increased producer prices.

Cities Service Gas Co. v. FERC, 627 F.2d 1027, 1031 (10th Cir. 1980). The Tenth Circuit correctly described this state of affairs as "arbitrary." *Id.* The Commission's new orders enforce equally arbitrary results which

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"nexus" existed between minimum bill provisions and take-or-pay liability on the ground that the failure of a single customer to purchase its minimum bill quantity of gas would not in all cases automatically cause the incurrence of an equivalent amount of take-or-pay costs by the pipeline. Pet. App. D at A-103 to A-104. The Court of Appeals affirmed, holding that the two matters were not "inextricably" related and that the Commission could therefore address the minimum bill issue while "deferring" corresponding take-or-pay relief. Pet. App. A at A-38 to A-40. But this hypertechnical response is inadequate, in the case of a pipeline in Trunkline's position, to prevent the gross monetary losses that will result from the potential massive loss of Trunkline's sales market combined with the immense and escalating take-or-pay exposure that will result from Trunkline being unable to sell its minimum bill quantities. Ironically, if Trunkline purchased from another pipeline, it would be permitted to pass through any remaining minimum bill of its seller in its own minimum bill, pursuant to the Court of Appeals remand. No such protection is provided Trunkline as a direct purchaser from producers. Finally, the Court of Appeals' holding was based on the understanding that the Commission was only "deferring" action on the take-or-pay issue, a concept that originated with the Commission, but has now been abandoned. *See Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol (Order No. 436)*, 49 Fed. Reg. at 42,462.

deprive pipelines of property interests without due process or just compensation.

CONCLUSION

There are two separate grounds on which the Commission's orders affirmed by the Court of Appeals should be reviewed by this Court. The first is that in attempting to impose a new market structure incorporating unbridled inter-pipeline competition and unrestricted "marketplace" pricing, the Commission has violated the public utility form of pipeline regulation envisioned by the NGA and the NGPA. The second is that the practical effect of the Commission's actions is to impose confiscatory rate levels on pipelines that have acquired new supplies in good faith efforts to fulfill the mandate of the NGPA. In both ways, the Court of Appeals' sanction of the Commission's action threatens the entire regulatory fabric of the NGA and the NGPA. Certiorari is therefore warranted.

Respectfully submitted,

RAYMOND N. SHIBLEY *
PATRICK J. WHITTLE
LEBOEUF, LAMB, LEIBY & MACRAE
1333 New Hampshire Ave., N.W.
Washington, D.C. 20036
(202) 457-7500
Attorneys for Trunkline Gas Company and Panhandle Eastern Pipe Line Company

* Counsel of Record

January 23, 1986

APPENDICES

TRUNKLINE/PANHANDLE APPENDIX A

NATURAL GAS ACT

§ 4(a), 15 U.S.C. § 717c(a)

All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

§ 4(e), 15 U.S.C. § 717c(e)

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go

into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

TRUNKLINE/PANHANDLE APPENDIX B

NATURAL GAS POLICY ACT OF 1978

§ 601, 15 U.S.C. § 3431

(a) Jurisdiction of the Commission under the Natural Gas Act

(1) Sales

(A) Natural gas not committed or dedicated

For purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)], effective on the first day of the first month beginning after November 9, 1978, the provisions of the Natural Gas Act [15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of November 8, 1978, solely by reason of any first sale of such natural gas.

(B) Committed or dedicated natural gas

Effective beginning on the first day of the first month beginning after November 9, 1978, for purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)], the provisions of such Act [15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of November 8, 1978, and which is—

(i) high-cost natural gas (as defined in section 3317(c)(1), (2), (3), or (4) of this title);

(ii) new natural gas (as defined in section 3312(c) of this title); or

(iii) natural gas produced from any new, onshore production well (as defined in section 3313(c) of this title).

(C) Authorized sales or assignments

For purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)], the provisions of the Natural Gas Act [15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply by reason of any sale of natural gas—

(i) authorized under section 3362(a) or 3371(b) of this title; or

(ii) pursuant to any assigned authorized under section 3372(a) of this title.

(D) Natural-gas company

For purposes of the Natural Gas Act [15 U.S.C. 717 et seq.], the term "natural-gas company" (as defined in section 2(6) of such Act [15 U.S.C. 717a(6) et seq.]) shall not include any person by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

(E) Alaskan natural gas

Subparagraph (B)(ii) and (iii) shall not apply with respect to natural gas produced from the Prudhoe Bay unit of Alaska and transported through the transportation system approved under the Alaska Natural Gas Transportation Act of 1976 [15 U.S.C. 719 et seq.].

(2) Transportation

(A) Jurisdiction of the Commission

For purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)] the provisions of such Act

[15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply to any transportation in interstate commerce of natural gas if such transportation is—

(i) pursuant to any order under section 3362 (c) or section 3363(b), (c), (d), or (h) of this title; or

(ii) authorized by the Commission under section 3371(a) of this title.

(B) Natural-gas company

For purposes of the Natural Gas Act [15 U.S.C. 717 et seq.], the term "natural-gas company" (as defined in section 2(6) of such Act [15 U.S.C. 717a (6)]) shall not include any person by reason of, or with respect to, any transportation of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission under the Natural Gas Act do not apply to such transportation by reason of subparagraph (A) of this paragraph.

(b) Charges deemed just and reasonable

(1) Sales

(A) First sales

Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if—

(i) such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter; or

(ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to part B of subchapter I of this chapter.

(B) Emergency sales

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid in any sale authorized under section 3362(a) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established under such section and applicable to such sale.

(C) Sales by intrastate pipelines

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d] any amount paid in any sale authorized by the Commission under section 3371(b) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established by the Commission and applicable to such sale.

(D) Assignments

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid pursuant to the terms of any contract with respect to that portion of which the Commission has authorized an assignment authorized under section 3372 (a) of this title shall be deemed to be just and reasonable if such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter.

(E) Affiliated entities limitation

For purposes of paragraph (1), in the case of any first sale between any interstate pipeline and any affiliate of such pipeline, any amount paid in any first sale shall be deemed to be just and reasonable if, in addition to satisfying the requirements of such paragraph, such amount does not exceed the amount

paid in comparable first sales between persons not affiliated with such interstate pipeline.

(2) Other charges

(A) Allocation

For purposes of sections 4 and 5 of the Natural Gas [15 U.S.C. 717c, 717d], any amount paid by any interstate pipeline for transportation, storage, delivery or other services provided pursuant to any order under section 3363(b), (c), or (d) of this title shall be deemed to be just and reasonable if such amount is prescribed by the President under section 3363 (h)(1) of this title.

(B) Transportation

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid by any interstate pipeline for any transportation authorized by the Commission under section 3371(a) of this title shall be deemed to be just and reasonable if such amount does not exceed that approved by the Commission under such section.

(c) Guaranteed passthrough

(1) Certificate may not be denied based upon price

The Commission may not deny, or condition the grant of, any certificate under section 7 of the Natural Gas Act [15 U.S.C. 717f] based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable under subsection (b) of this section.

(2) Recovery of just and reasonable prices paid

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], the Commission

may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if—

> (A) under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act [15 U.S.C. 717c, 717d], and
>
> (B) such recovery is not inconsistent with any requirement of any rule under section 3341 of this title (including any amendment under section 3342 of this title),

except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.

Supreme Court, U.S.
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Nos. 85-1219, *et al.*

85-1236 (6)
85-1237 (6)
85-1250 (7)
85-1252 (8)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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BRIEF OF RESPONDENTS TENNESSEE GAS PIPELINE COMPANY AND MIDWESTERN GAS TRANSMISSION COMPANY IN SUPPORT OF PETITIONS FOR WRIT OF CERTIORARI

MICHAEL R. WALLER, *Senior Vice President & General Counsel*
TERENCE J. COLLINS, *Deputy General Counsel*
TENNESSEE GAS TRANSMISSION COMPANY
P.O. Box 2511
Houston, Texas 77001

*HAROLD L. TALISMAN
JAMES T. MCMANUS
MICHAEL E. SMALL
WRIGHT & TALISMAN P.C.
1050 17th Street, N.W.
Suite 600
Washington, D.C. 20036
(202) 331-1194

**Counsel of Record*

February 10, 1986

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

List Of Affiliates Of Tennessee Gas Pipeline Company And Midwestern Gas Transmission Company Who Are Not *Wholly Owned By Tenneco Inc. Pursuant To Rule 28.1*

Adela Investment Company S.A.
Akulu Marchon (PTY) Ltd.
Akulu Chemicals (PTY) Ltd.
Albright, Morarji and Pandit Limited
Albright & Wilson (Australia) Ltd.
Albright & Wilson Match Phosphorous Co. Ltd.
Arndale Fuels Ltd.
Bracey Petroleum Products Ltd.
Butler Oil Products Ltd.
Case Poclain GmbH & Co.
Collins Pipeline Company
Depositas Del Norte, S.A.
FC Marine Inc.
Gardinol Products (PTY), Ltd.
HT Gathering Company
Intertractor Viehmann GmbH & Co.
J.I. Case do Brasil & Cia.
Kern Island Water Company
Kern River Canal and Irrigating Company
Kern River Gas Transmission Company
Losenhausen Maschinenbau AG & Co.
Losenhausen Maschinenbau AG
Marchon-Paragon Holdings (PTY) Limited
Marchon-Paragon Sulphonation (Cape) (PTY) Ltd.
Marchon-Paragon Sulphonation (PTY) Ltd.
Mistal Inc.
Monroe Auto Pecas S.A.
National Brands (PTY), Ltd.

Omni-Pac GmbH
P.P.M. Guindastes Hidraulicos S.A.
Pholyphosphates Inc.
Poclain S.A.
S.A. Paper Chemicals (Proprietary), Limited
Sara Gretes Cafetria AB
Skogstre A/S
Stoco Mutual Water and Sewer Company
T & M Terminal Company
Tees Storage Company Limited
Tenneco Insurance Ventures Inc.
Tenneco Oil Company of Nigeria Unlimited
Tenneco Oil of Nigeria Unlimited
Tenngasco Gas Gathering Company
Tess Storage Company Limited
TENN-USS Chemicals Finance Corporation
Tractortechnic Canada, Ltd.
Universal Chemical Contractors (PTY)
Vibromax France SARL
Vibromax France SCI
W.R. John & Company (Rumney) Ltd.

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BRIEF OF RESPONDENTS TENNESSEE GAS PIPELINE COMPANY AND MIDWESTERN GAS TRANSMISSION COMPANY IN SUPPORT OF PETITIONS FOR WRIT OF CERTIORARI

Tennessee Gas Pipeline Company (Tennessee) and Midwestern Gas Transmission Company (Midwestern)[1]

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[1]Tennessee and Midwestern were parties to the proceeding below. They are natural gas pipeline companies engaged primarily in the business of purchasing, transporting and selling

support the petitions for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit filed by Transwestern Pipeline Company (No. 85-1219), ANR Pipeline Company (No. 85-1236), Texas Eastern Transmission Corporation (No. 85-1237), Trunkline Gas Company and Panhandle Eastern Pipe Line Company (No. 85-1250), and Arkla Energy Resources (No. 85-1282). These petitions challenged a decision of the United States Court of Appeals for the District of Columbia Circuit (App. A-1)[2] upholding a series of rulemaking orders of the Federal Energy Regulatory Commission (Commission or FERC) that declared unlawful longstanding and previously authorized minimum contractual purchase

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natural gas in interstate commerce under authority granted by and subject to the jurisdiction of the Commission under the Natural Gas Act. Tennessee's main transmission system extends northeastward from its supply sources in Texas, Louisiana and the Gulf of Mexico into sixteen states terminating in New England. Its sales are made to gas distribution companies and other pipelines which resell the gas being ultimately consumed in twenty-two states, primarily in the Middle Atlantic, Midwest and New England regions. At the end of 1983, Tennessee had over three billion dollars of utility plant in service, including almost fourteen thousand total miles of pipeline. Midwestern has two separate pipeline systems. Midwestern's Southern System extends from Portland, Tennessee, where it purchases its gas supply from its affiliate, Tennessee, to Joliet, Illinois. It sells primarily to gas distributors who resell the gas in the greater Chicago-Gary area. Its Northern System buys natural gas from a Canadian supplier, and its principal customer is ANR Pipeline Company, which primarily serves the states of Wisconsin and Michigan. At the end of 1983, Midwestern had about one-hundred sixty million dollars of utility plant in service, including over nine hundred miles of pipeline.

[2]The appendix references are to the appendix filed with this Court by Transwestern.

commitments by pipeline customers that enabled the recovery of variable costs through minimum commodity bills.[3] In the interests of brevity, Tennessee and Midwestern hereby adopt the statements of the case, statutes involved, jurisdiction and opinions below submitted in the petition of Trunkline Gas Company and Panhandle Eastern Pipe Line Company.[4]

REASONS FOR GRANTING THE WRIT

This case involves fundamental and important questions concerning the Commission's authority to release partial requirements customers of pipelines from previously authorized and longstanding minimum purchase commitments while at the same time holding pipelines to their contractual agreement to provide certain maximum volumes to those customers upon demand. The case is not only vitally important to pipelines because they have made multi-million dollar investments in facilities and have entered into minimum gas purchase obligations with producers and suppliers in reliance on the contract provisions that have been set aside, but also to the pipelines' entire requirements customers who will have to bear a much greater portion of cost of service of the pipeline.

I.

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[3]These orders were issued in Commission Docket No. RM83-71 and are identified as Order No. 380 (App. A-71), 380-A (App. A-129), 380-B (App. A-226), 380-C (App. A-231), and 380-D (App. A-271).

[4]The issues addressed here relate to questions presented for review by Transwestern Pipeline Company and Texas Eastern Transmission Corporation.

FERC HAS DESTROYED THE BASIC CONTRACTUAL UNDERPINNINGS OF THE NATURAL GAS INDUSTRY WITHOUT SATISFYING THE REQUIREMENTS FOR SUCH CONTRACTUAL ABROGATION SET FORTH IN THIS COURT'S DECISIONS

Over the last thirty years in cases under the Natural Gas Act (15 U.S.C. § 717, *et seq.*), this Court has repeatedly recognized the importance of private contracts between interstate pipelines and their customers and has held that such contracts may be abrogated "only in circumstances of unequivocal public necessity." *In Re Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968), *citing United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *accord Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 582 (1981). The basis for this heavy burden was that "preserving the integrity of contracts . . . permits the stability of supply arrangements which all agree is essential to the health of the natural gas industry." *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. at 344; *see also U.S.* v. *El Paso Natural Gas Co.*, 376 U.S. 651, 660 (1964) ("pipelines are very expensive; and to be justified they need long-term contracts for sale of gas that will travel them"); *Tampa Electric Co.* v. *Nashville Coal Co.*, 365 U.S. 320, 334 (1962) ("in the case of public utilities the assurance of a steady and ample supply of fuel is necessary in the public interest. . . . The compelling validity of such considerations has been recognized fully in the natural gas public utility field.").

The court below did not determine whether the Commission's action abrogating these private con-

tracts met this Court's standard of "unequivocal public necessity." Thus, it requires review by this Court to determine whether contract provisions such as these can be abrogated under the Commission's rule without meeting this standard.

Review is further warranted because the Commission abrogated these contracts, notwithstanding the reliance placed on such contracts by interstate pipelines, such as Tennessee and Midwestern. It cannot be disputed that minimum commodity bills were essential parts of gas supply contracts entered into between interstate pipelines and their customers. In the case of Tennessee and Midwestern, the bargain struck with their partial requirements customers was that Tennessee and Midwestern would provide those customers with a specified firm volume of gas upon demand and the customers' payments would be subject to a minimum commodity bill based on $66^{2}/_{3}\%$ of the monthly volume they were entitled to demand. In this way, the partial requirements customer, which is a reseller of gas and closer to the ultimate market than Tennessee and Midwestern, shared in the risk of market fluctuations.

Based on these agreements, Tennessee and Midwestern undertook the multi-million dollar investments necessary to meet those customers' requirements. Tennessee entered into supply contracts with producers which also contained minimum take-or-pay obligations, and Midwestern undertook minimum bill obligations to its suppliers. These bargained-for minimum commodity bill provisions, which have been in Tennessee's and Midwestern's contracts and tariffs from the inception of service to such customers, were found to be required by the public con-

venience and necessity when the service to the customer was first certificated and have time and time again in numerous rate proceedings been a part of the tariff provisions that were approved as just and reasonable under the standards of Sections 4 and 5 of the Natural Gas Act. The Commission's elimination of the minimum commodity bills penalizes pipelines, such as Tennessee and Midwestern, for that reliance and effects an after-the-fact change in the governing rules.

Furthermore, in support of this abrogation of these longstanding contracts, the Commission's basic thesis accepted by the court below involved generalized statements of the benefits of competition.[5] The Commission made no attempt to show "unequivocal public necessity" as required by this Court (App. A-81, A-100), nor did the court below require such a finding (App. A-18).

The D.C. Circuit's acceptance of the Commission's general assertions of the benefits of competition is squarely contrary to *FCC* v. *RCA Communications*, 346 U.S. 86, 94 (1953) where this Court rejected a like order based on the mere recitation, without thorough study, that competition may have beneficial effects.

Therefore, the petitions should be granted because the court below ignored longstanding decisions of this Court which require a finding of "unequivocal public

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[5]The Commission performed no studies to support its findings. The Commission relied for the most part on general comments submitted by partial requirements customers of interstate pipelines who supported the Commission's proposal (*see* e.g. App. A-88 n. 28).

necessity" before the private contracts at issue here can be abrogated.

II.

THE COURT BELOW ERRED IN AFFIRMING A RULE WHICH RESTRUCTURED THE NATURAL GAS INDUSTRY BUT FAILED TO RESOLVE THE LINKED IMPACT OF ITS ACTIONS ON TAKE-OR-PAY

As the court below recognized, the Commission cannot issue a rule such as this without also resolving inextricably linked issues (App. A-38). Where the court erred, though, was in not recognizing that take-or-pay provisions between producers and interstate pipelines are inextricably linked with minimum commodity bills that exist between interstate pipelines and their customers.

It is clear that, in reliance on their sales contracts which contained minimum commodity bills recovering variable costs, pipelines in turn contracted for gas supplies from producers. These supply contracts typically include take-or-pay provisions which are similar in nature to the minimum commodity bills that were the subject of the Commission's rule. While it could not be disputed below that the same policy considerations could support elimination of these counterpart take-or-pay and minimum bill provisions alike, the court, as did the agency below, refused to require concurrent resolution of these inextricably related matters (App. A. 39-40). In thus failing to come to grips with the pipeline's take-or-pay obligations at the supply end of the pipeline system while eliminating the counterpart purchase obligations owing to

the pipeline at the opposite end of the pipeline system, the pipeline has been arbitrarily stripped of its right to contract with its purchasers in a way that corresponds with its purchase obligations to its suppliers.

If a more competitive marketplace is the *raison d'etre* below, then it must be recognized that in a truly competitive marketplace a customer could not expect its pipeline supplier to undertake massive gas supply commitments when, on the other hand, it could be relieved of its corresponding purchase obligations to the pipeline. Ironically, only regulation would have it so. But regulation must be a two way street, and the pipeline must likewise be relieved of its corresponding purchase obligations.

This lack of evenhanded treatment of these mutual, balanced seller-purchaser relationships which coexist at each end of the pipeline results in additional costs being borne by the pipeline and by its full requirements customers that have no alternative sources of supply. Thus, the take-or-pay and minimum commodity bill issues are inextricably linked as demonstrated by the substantial take-or-pay cost consequences that result if variable costs are not recovered in minimum commodity bills.

Review by this Court is therefore warranted because of the failure by the court below to recognize the inextricable link between take-or-pay and the recovery of variable costs in minimum commodity bills and to therefore, require the Commission to resolve the take-or-pay issue concurrently with the minimum bill issue.

CONCLUSION

For the reasons set forth above, this Court should issue a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit.

Respectfully submitted,

WRIGHT & TALISMAN, P.C.

By_____
*HAROLD L. TALISMAN
JAMES T. MCMANUS
MICHAEL E. SMALL

1050 17th Street, N.W.,
Suite 600
Washington, D.C. 20036
(202) 331-1194

Counsel of Record

MICHAEL R. WALLER, *Senior Vice President & General Counsel*
TERENCE J. COLLINS, *Deputy General Counsel*
TENNESSEE GAS TRANSMISSION COMPANY
P.O. Box 2511
Houston, Texas 77001

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Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR RESPONDENT NORTHERN ILLINOIS GAS COMPANY IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

DAVID I. BLOOM *
MAYER, BROWN & PLATT
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 463-2000

ROBERT A. HELMAN
STEPHEN M. SHAPIRO
WENDELL H. ADAIR, JR.
MAYER, BROWN & PLATT
231 South LaSalle Street
Chicago, Illinois 60604

Attorneys for
Northern Illinois Gas Company

March 24, 1986

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission (the "Commission") has authority under the Natural Gas Act, 15 U.S.C. §§ 717-717w (1982), to regulate and modify the rates charged by natural gas pipelines under minimum commodity bill provisions included in tariffs on file with the Commission.

2. Whether the court of appeals acted correctly in upholding the decision of the Commission to order the elimination of all variable costs from the rates charged under minimum commodity bills.

3. Whether the Commission may modify the rate provisions of tariffs on file with it on the basis of a record compiled in an informal rulemaking proceeding.

STATEMENT PURSUANT TO RULE 28.1

Northern Illinois Gas Company is a subsidiary of NICOR Inc., a publicly-held company. NICOR Inc. is not affiliated with any companies other than its wholly-owned subsidiaries.

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---

BRIEF FOR RESPONDENT NORTHERN ILLINOIS GAS COMPANY IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the court of appeals is reported at 770 F.2d 1144 and appears at Pet. App. A-1.[1] The court of appeals' orders denying rehearing and re-

[1] References to "Pet. App. ——" appearing herein are to the Appendix to the Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit filed January 21, 1986 in Transwestern Pipeline Co. v. Federal Energy Regulatory Commission, No. 85-1219.

hearing *en banc*, are not officially reported and appear at Pet. App. A-57 and A-69, respectively. The orders of the Federal Energy Regulatory Commission (the "Commission") were issued in Docket No. RM83-71-000 and are identified as Order Nos. 380 (Pet. App. A-71), 380-A (Pet. App. A-129), 380-B (Pet. App. A-226), 380-C (Pet. App. A-231) and 380-D (Pet. App. A-271).

JURISDICTION

The decision of the court of appeals and its judgment in this case were entered August 20, 1985. A timely petition for rehearing and a suggestion for rehearing *en banc* were denied on October 25, 1985. This Court has jurisdiction to review the decision below pursuant to 15 U.S.C. § 717r(b) and 28 U.S.C. § 1254(1).

STATEMENT

1. Under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717-717w(1982), sales of natural gas for resale by interstate pipelines are subject to the comprehensive jurisdiction of the Commission. No such sales can take place unless the Commission has issued a certificate of public convenience and necessity under Section 7 of the NGA. 15 U.S.C. § 717f(1982). Once the service is commenced, Section 4(a) of the NGA provides that the rates and charges are "subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful." 15 U.S.C. § 717c(a) (1982). Under Section 5(a) of the NGA, if the Commission finds that "any rate, charge, or classifi-

cation. . . . or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential," the Commission may fix by order the "just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed, and in force. . . ." 15 U.S.C. § 717d(a) (1982).

Generally, an interstate pipeline will have entered into a contract with each resale customer requiring the pipeline to provide, upon request on any given day, a maximum quantity of natural gas (the "daily contract quantity"). The rates for services to be charged under the contract will be contained in tariffs on file with and subject to the review of the Commission. To compensate the pipeline for the costs associated with providing gas sales service on demand, the tariff will require each customer to pay a monthly demand charge, based on the contract quantity, which recovers a portion of the fixed costs incurred by the pipeline in providing the service.[2] A customer must pay the demand charge, whether or not it actually requests or receives service during any billing period and irrespective of the level of service actually received. A customer also is required to pay a commodity charge based on the actual volume of gas purchased from the pipeline. The commodity charge is designed to recover the remaining portion of the pipeline's fixed costs and all variable costs, including purchased gas costs.

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[2] The exact portion depends upon the rate design used by the pipeline. The portions range from 25% to 70% of a pipeline's total fixed costs. Pet. App. A-76 n.14. *See generally* Columbia Gas Transmission Corp. v. F.E.R.C., 628 F.2d 578 (D.C. Cir. 1979).

In addition, some pipeline tariffs impose an additional charge, known as a minimum commodity bill. Minimum commodity bills require a customer to pay a charge for any shortfall in purchases below a specified level, ranging from 50% to 90% of the monthly or annual contract quantity, even though the customer does not actually purchase that quantity of gas.[3] Prior to the issuance of Order No. 380, most minimum bill charges were set at the level of the pipeline's commodity charge, including purchased gas costs. Thus, a pipeline customer purchasing only at the pipeline minimum bill level could never replace a unit of those purchases with alternate, less expensive supplies because the true cost of that unit, which would include the pipeline minimum bill charge, could never be less than the pipeline commodity price. Minimum commodity bills therefore established an effective floor on purchases by a customer from its supplying pipeline and placed a substantial restraint on the forces of competition.

2. In August 1983, the Commission issued a Notice of Proposed Rulemaking in which it proposed to remove all variable costs, including the cost of purchased gas, from the rates charged under minimum commodity bills. It noted that variable costs are not incurred when a pipeline does not make sales and therefore tentatively concluded that current minimum bills might allow pipelines to recover a "windfall." It also concluded that minimum commodity

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[3] The monthly quantity generally equals the daily contract quantity times the number of days in the applicable month. If a customer's entitlement to firm sales volumes is less than the daily contract quantity times the days in the applicable period, the percentage requirement of the minimum commodity bill usually is applied to that lower volume.

bills served as barriers to competition by preventing pipeline customers from purchasing less expensive sources of supply. After receiving an initial round of comments, the Commission allowed interested parties to file reply comments.

Thereafter, the Commission promulgated Order No. 380, based on its findings that minimum commodity bills recovered costs that were not actually incurred, Pet. App. A-82 to A-85, and, further, were "anticompetitive." Pet. App. A-85 to A-92. To implement these conclusions, the Commission promulgated a new section to its regulations, 18 C.F.R. § 154.111, effective August 30, 1984, which required all costs of purchased gas to be excluded from the rate charged when customers did not purchase gas at full minimum bill levels. Pet. App. A-123 to A-124.[4] All other variable costs were required to be eliminated from the minimum commodity bill when each pipeline made its next general rate filing under Section 4 of the NGA. *Ibid.* The Commission declined to adopt the suggestion of some parties that minimum commodity bills be eliminated in their entirety or be applied to a lesser percentage of contract quantity. Pet. App. A-114 to A-115. It therefore left intact the volumetric level of minimum commodity bills and the fixed cost portion of the rates charged thereunder.

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[4] The Commission also applied this provision to "minimum take provisions," which require customers physically to receive a specified amount of gas. The court of appeals upheld the Commission's decision to apply 18 C.F.R. § 154.111 to both minimum bill and minimum take provisions, holding that "there is no difference between the two types of clauses with respect to the Commission's rationale for the rule. . ." Pet. App. A-35 n.18.

The Commission's decision to leave intact the fixed cost portion of the rate charged under minimum commodity bills has several effects. First, it provides affected pipelines with continued assurances of recovery of the fixed costs contained in their commodity charges. Pet. App. A-22, A-138, A-143. Thus, pipelines will continue to have a full and fair opportunity to recover all costs actually incurred in meeting their contractual obligations to their customers.

Second, by retaining the pre-existing floor on the contribution to fixed cost recovery by each customer (*i.e.*, the demand charge plus commodity fixed costs for volumes up to the minimum bill level), the Commission's rule protects pipeline customers against the full impact of cost-shifting if purchase levels shift in response to Order No. 380.

Third, the scope of the Commission's action limits its competitive impact. Rather than exposing pipelines to the full brunt of gas-on-gas competition, the orders leave pipelines with a partial shield against competition. Under the rule, a pipeline's sales to a customer will drop below the minimum commodity bill level in response to competition only if the rates of competitors are lower than the pipeline's rates by an amount greater than the fixed costs contained in the pipeline's commodity charge. Even if that condition is met and a pipeline actually loses sales, the pipeline will remain shielded from the full financial impact of that competition because it will continue to recover those fixed costs.

Fourth, to the extent that sales are lost and take-or-pay liability results,[5] the Commission left undis-

[5] Under certain gas purchase contracts, a purchaser must take a specified amount of gas, or pay for that amount even if not taken. Pet. App. A-20 to A-21.

turbed those provisions of its regulations which allow a pipeline to recover the carrying-costs associated with take-or-pay liability. Pet. App. A-105 n.47. It also invited pipelines to file proposals to target those costs on specific customers if such proposals could be justified. Pet. App. A-106.

3. After petitions for rehearing were denied by the Commission, several parties petitioned the United States Court of Appeals for the District of Columbia Circuit for review of the Commission's orders, pursuant to 15 U.S.C. § 717r(b) (1982). The court of appeals affirmed the Commission, holding that the Commission had the statutory authority to issue the rule, because "Sections 4 and 5 of the Natural Gas Act empower the Commission to regulate rates, charges, and practices of natural gas companies under its jurisdiction." Pet. App. A-24 to A-25. The court of appeals also concluded that "[t]he Commission has provided abundant evidence that the recovery of variable costs through minimum bill and minimum take clauses prevents customers from shopping for low-cost gas, thereby insulating pipelines from market forces that would otherwise drive gas prices down." Pet. App. A-36. The court of appeals, after review of the record, then determined that "the Commission adequately addressed the concerns of captive customers," Pet. App. A-42, that "each of the order's essential elements is supported by substantial evidence," *ibid.*, and therefore that it was not its "province 'to supplant the Commission's balance of these interests with one more nearly to [our] liking.' *Permian Basin*, 390 U.S. at 792." *Ibid.* The court of appeals also held that the Commission was authorized to promulgate the rule after informal notice

and comment rulemaking because "the decision whether to proceed by rulemaking or adjudication lies within the broad discretion of the agency," Pet. App. A-51, and "the 'substantial evidence' provision in the Natural Gas Act does not affect the *procedure* the Commission is required to follow." Pet. App. A-54 (emphasis in original).

4. Northern Illinois Gas Company ("NI-Gas"), a respondent in this case, is a local distribution company engaged in the sale and distribution of natural gas to over 1,500,000 customers in northern Illinois. Historically, NI-Gas has purchased close to 100% of its supply from interstate pipelines, three of which have minimum commodity bills in the tariffs applicable to NI-Gas. Because these minimum commodity bills had increased the cost of gas to the consumers served by NI-Gas, NI-Gas actively supported the proposed rule and defended the final rule before the court of appeals. At the time the Commission was receiving comments in the rulemaking that resulted in Order No. 380, NI-Gas estimated that its consumers would save tens of millions of dollars per year as a direct result of the additional flexibility to substitute lower priced sources of gas for higher priced gas which NI-Gas previously had been forced to purchase. Because the rule increases NI-Gas' options for buying gas and the competition among pipelines and other sources of gas, NI-Gas anticipates that the combined impact of its increased flexibility and increased industry-wide competition will result in rates charged to its consumers that are tens of millions of dollars below the level which would prevail absent Order No. 380.

REASONS FOR DENYING THE PETITIONS

The unanimous decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. The court of appeals properly applied well-established standards for review of Commission action. After careful consideration of the record below, the court of appeals determined that the Commission's findings were supported by substantial evidence and that the Commission's actions were within its substantive authority and in accord with appropriate procedural safeguards. Petitioners' challenges to the decisions of the court of appeals and the Commission boil down to dissatisfaction with the application of settled legal principles to the facts of this particular record, and do not merit review by this Court.

I.

The decision below evidences no confusion as to the appropriate standards of review. It applies long-standing principles of judicial review of agency action in a carefully reasoned opinion. Having properly articulated these standards, the decision then applies them to a voluminous record, and determines that the actions of the Commission satisfy those standards. Thus, while the rule promulgated by the Commission might have broad impact, the review afforded by the court of appeals was sufficient to dispose of all of petitioners' contentions.

This Court has defined the responsibilities of a court reviewing agency actions taken under the NGA in the following terms:

> First, it must determine whether the Commissioner's order, viewed in light of the relevant

> facts and of the Commission's broad regulatory duties, abused or exceeded its authority. Second, the court must examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order's essential elements is supported by substantial evidence. Third, the court must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests. . . . The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly of its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors.

Permian Basin Area Rate Cases, 390 U.S. 747, 791-792 (1968). As described more fully in Parts II and III of this brief, the court of appeals properly applied each of these standards in reviewing the actions of the Commission. First, the court of appeals considered whether the actions of the Commission were within its substantive authority under the NGA and properly concluded that they were. Second, the court of appeals reviewed the record and determined that each of the essential elements of Order No. 380 was fully supported by substantial evidence. Third, the court of appeals determined that Order No. 380 adequately protected investors by maintaining the fixed cost portion of minimum commodity bills and providing a fair opportunity for pipelines to recover all prudently incurred costs.

Thus, the present case involves a routine review of administrative action under well-established legal

principles. As this Court has made clear, the responsibility for assessing a record to determine whether agency findings are supported by substantial evidence "is not ours," but that of the "courts of appeals." "This Court will intervene only in what ought to be the rare instance where the standard appears to have been misapprehended or grossly misapplied." *Mobil Oil Corp. v. F.P.C.*, 417 U.S. 283, 309-310 (1974).

II.

The court of appeals concluded that the Commission had explicit statutory authority to take the actions herein challenged. Pet. App. A-25. Section 5(a) of the NGA, 15 U.S.C. § 717d(a)(1982), states that if the Commission "find[s] that any rate, charge. . . . or any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable," the Commission shall fix by order "the just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed. . ." Minimum commodity bills establish the "just and reasonable rate" to be paid by a pipeline customer when it fails to achieve a contractually agreed-upon level of purchases. Pet. App. A-25 n.9. The Commission's rule did not alter those levels or a customer's obligation to compensate a pipeline for the prudently incurred costs of providing service. The orders merely concluded that a rate for shortfalls of purchases below a pipeline's minimum bill level *which recovers costs not actually incurred* is "unjust [and] unreasonable" within the meaning of Section 5 of the NGA, 15 U.S.C. § 717d(1982), and therefore prohibited that practice on a prospective basis. Such regulation of rates and charges is precisely the au-

thority granted the Commission by Section 5 of the NGA.[6]

Petitioners' efforts to portray the Commission actions as a prohibited alteration of certificates were properly rejected by the court of appeals, Pet. App. A-25 n.9,[7] and petitioners' reliance on cases such as *United States v. Seatrain Lines, Inc.*, 329 U.S. 424 (1947), is misplaced. A certificate of public convenience and necessity issued under Section 7 of the NGA confers upon the recipient the right and obligation to provide a specific service. Absent a certificate, a party is prohibited from providing the specified service. However, the determination of the just and reasonable rate level for a particular service, which must recognize the financial interests of the pipeline, is a far different matter from revoking a pipeline's right to provide that service. The orders of the Commission, which operate on a prospective basis only, leave intact the service rights and obligations of pipelines, including each customer's obligation to com-

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[6] Petitioners' reliance on United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956), and F.P.C. v. Sierra Pacific Power Co., 350 U.S. 348 (1956), is entirely misplaced. *E.g.*, No. 85-1219 Pet. at 8-11. Those cases deal only with the burden of proof and do not question the Commission's substantive ratemaking authority under Section 5 of the NGA when adequate findings are made by the Commission.

[7] The court of appeals also properly concluded that a certificate confers no guarantee that the initial terms of an approved service will not be changed, citing Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378, 389 (1959). Upon appropriate showings, "the Commission has plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." Permian Basin Area Rate Cases, *supra*, 390 U.S. at 783-84.

pensate the pipelines, and the orders deal solely with the rates charged for one element of service. Thus, *Seatrain*, even if read as broadly as petitioners contend, is not relevant to the present case.

III.

Petitioners, in various guises, also argue that the Commission's rule "abrogates" contracts, destroys the "mutuality" of contracts, or denies pipelines the constitutionally-mandated fair opportunity to recover their costs. *E.g.*, No. 85-1250 Pet. at 9-10; No. 85-1236 Pet. at 9; No. 85-1237 Pet. at 10. As the court of appeals properly concluded, these arguments are devoid of merit. Pet. App. A-25 n. 9.

Under Order No. 380, pipeline customers remain obligated to pay a demand charge to compensate their supplying pipelines for standing ready to provide service up to the daily contract quantity specified in the contracts. Customers remain obligated to pay commodity charges for actual purchases and fixed costs for any minimum bill deficiency volumes. Simply put, pipeline customers remain obligated to compensate pipelines for costs prudently incurred to provide the contracted-for service, preserving mutuality between the providers and recipients of gas sales services. All the Commission did, by invoking its authority under Section 5 of the NGA, was to hold that it is "unjust [and] unreasonable" for a pipeline *to charge customers for costs which it has not incurred.*

This decision by the Commission is clearly within the power granted by the NGA and its finding that the previous rate structure for minimum commodity bill charges is unjust and unreasonable fully satisfies the requirements established by the Court in the *Mobile-Sierra* doctrine. The *Mobile-Sierra* line of

cases recognizes the primary role played by contracts under the NGA. It does not, however, prohibit the Commission from exercising its powers under Section 5 of the NGA to prescribe just and reasonable rates. The ability of the Commission to modify contractually specified rates is beyond peradventure. "The basic power of the Commission is that given it by § 5(a) to set aside and modify any rate or contract which it determines after hearing, to be 'unjust, unreasonable, unduly discriminatory, or preferential'." *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, *supra*, 350 U.S. at 341. *See also F.P.C. v. Louisiana Power and Light Co.*, 406 U.S. 621, 646-47 (1972).

The finding of the Commission that minimum bill charges which recover unincurred costs are unjust and unreasonable cannot be characterized as arbitrary or capricious. The two essential elements of the Commission's findings, that minimum bills authorize the recovery of unincurred costs and inhibit competition, are uncontroverted. Petitioners do not dispute the conclusion of the Commission that purchased gas costs are not incurred. At most, they argue that other costs, primarily take-or-pay costs which may be claimed by producers under gas purchase contracts, may be incurred if the orders remain in effect. They further argue that while minimum commodity bills admittedly restrain competition, such bills provide pipelines with both the constitutionally-protected fair opportunity to recover their prudently-incurred costs and the additional right to retain a fixed market share, irrespective of any other factors, citing *United States v. El Paso Natural Gas Company*, 376 U.S. 651, 659-660 (1964).

However, this claim misstates the law and the impact of the Commission rule. While minimum commodity bills have been justified for several reasons,[8] an absolute grant of immunity from competition is not one of those reasons. The Commission may promote competition to better serve the public interest.[9] The sole issue is whether its actions properly recognize the financial interests of pipelines and fairly compensate investors. *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 790-91; *F.P.C. v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942); *Lynchburg Gas Co. v. F.P.C.*, *supra*, 336 F.2d at 949-50 (Washington, J., concurring).

The Commission's rule, as found by the court of appeals, strikes a reasonable balance between effective competition and the expectations of investors in a manner consistent with the requirements established by this Court. The final Commission rule provides each affected pipeline with a full and fair opportunity to recover its cost of service, including the costs associated with any increased take-or-pay liability. Demand charges, which recover a significant portion of pipeline fixed costs, are unaffected by the rule. The fixed costs recovered through the pipeline's commodity charge are also unaffected because the

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[8] *See generally* Mississippi River Transmission Corp. v. F.E.R.C., 759 F.2d 945 (D.C. Cir. 1985); Atlantic Seaboard Corp. v. F.P.C., 404 F.2d 1268 (D.C. Cir. 1968); Lynchburg Gas Co. v. F.P.C., 336 F.2d 942 (D.C. Cir. 1964). Both the Commission and the court of appeals concluded that Order No. 380 satisfied the standards set forth in those cases.

[9] *See generally* Otter Tail Power Co. v. United States, 410 U.S. 366 (1973); Atlantic Seaboard Corp. v. F.P.C., *supra*, 404 F.2d at 1272; Northern Natural Gas Co. v. F.P.C., 399 F.2d 953, 964-65 (D.C. Cir. 1968).

minimum commodity bills continue in effect, at pre-existing levels, for such fixed costs. Only variable costs, which by definition are *not* incurred when purchases are not made, are excluded from recovery through the minimum bill charge.

Petitioners argue, however, that these unincurred variable costs are a proxy for take-or-pay costs which are an inevitable result of Order No. 380. This argument overlooks the fact that if a pipeline loses sales due to the rule and therefore incurs take-or-pay liability to producers, those costs may be reflected in its rates. Such payments, if prudently incurred, are placed in the pipeline's rate base and the pipeline may recover in its rates the carrying costs associated with that rate base account. Pet.App. A-105 n. 47. Thus, the pipeline receives a full and fair opportunity to recover its costs. The consumers' interests are therefore balanced with the pipeline's financial health. *Cf., Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 792; *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Arguments that the Commission's rule creates a new market structure or results in confiscatory rate structures are completely without merit.

Certain petitioners also argue that the rule is arbitrary because it will foster cost-shifting among customers. *E.g.*, No. 85-1236 Pet. at 11. But the continued availability of demand charges and fixed cost minimum commodity bills limits the potential for the shifting of fixed costs among customers. The sole potential for such cost-shifting arises if and when the pipeline reflects in its rates take-or-pay costs caused by the rule. To the extent any misallocation results, the Commission has invited pipelines to

propose allocations which properly assign such costs. Pet. App. A-106.

Thus, pipelines will continue to be fairly compensated for all costs prudently incurred in providing sales service up to the maximum contract quantities embodied in the service agreements. The financial obligations of pipeline customers remain tied to the same benchmarks. The Commission's rule merely seeks to promote competition by prohibiting pipelines from recovering costs which they themselves must acknowledge are not incurred.

IV.

The Commission adopted its rule after an informal notice and comment process, allowing for the filing of reply comments as well as the statutorily authorized petitions for rehearing. The court of appeals affirmed this use of informal rulemaking proceedings as consistent with the statutes, its precedents, and the decisions of this Court.

The statutes and precedents authorize the Commission to establish rates pursuant to rulemaking procedures.[10] Section 403(c), of the Department of Energy Organization Act, 42 U.S.C. § 7173(c)(1982) ("DOE Act"), states: "Any function. . . . which relates to the establishment of rates and charges under the. . . . Natural Gas Act, may be conducted by rulemaking procedures." Moreover, this Court has clearly sanctioned agency discretion in selecting its procedures:

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[10] Petitioners argue that, in promulgating the rule, the Commission was not exercising its ratemaking authority. No. 85-1219 Pet. at 22-25; No. 85-1252 Pet. at 10-12. We have responded to this argument on pp. 11-13, *supra*.

> Absent constitutional constraints or extremely compelling circumstances the "administrative agencies 'should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties'." *FCC v. Schreiber*, 381 U.S., at 290, 85 S. Ct. at 1467, quoting from *FCC v. Pottsville Broadcasting Co.*, 309 U.S., at 143, 60 S. Ct., at 441. Indeed, our cases could hardly be more explicit.

Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., 435 U.S. 519, 543-44 (1978). An agency may choose to proceed through either adjudication or rulemaking proceedings, *SEC v. Chenery Corp.*, 332 U.S. 194, 201-03 (1947), and it must "be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties." *Permian Basin Area Rate Cases, supra*, 390 U.S. at 790. The statutory requirement of a hearing may be satisfied by written comments. *United States v. Florida East Coast Ry. Co.*, 410 U.S. 224, 241 (1973). Given the Court's decisions in *Vermont Yankee* and *Florida East Coast Ry.*, the courts of appeals in this case and others consistently have concluded that the Commission may proceed by rulemaking in carrying out its responsibilities under the NGA. *E.g.*, Pet. App. A-50 to A-56; *Phillips Petroleum Co. v. F.P.C.*, 475 F.2d 842 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974); *Tenneco Oil Co. v. F.E.R.C.*, 571 F.2d 834 (5th Cir.), *cert. dismissed*, 439 U.S. 801 (1979).

Petitioners nonetheless argue that *Florida East Coast Ry.* and *Vermont Yankee* prohibit the use of informal rulemaking procedures in this context because "disputed facts" were raised and the Commis-

sion was "making a 'quasi-judicial' determination by which a very small number of persons are 'exceptionally affected, in each case, upon individual grounds, . . .'" No. 85-1237 Pet. at 12, *citing Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., supra*, 435 U.S. at 542. This argument is meritless because the present case clearly raises "policy-type rules or standards" applicable to all competitors in a regulated industry.[11] The conclusion of the Commission that minimum commodity bills permit the recovery of unincurred costs cannot be disputed, nor can the conclusion that such minimum commodity bills adversely affect competition. And the balance to be struck between competition and other values under the NGA, within constitutional and statutory limits, is plainly a matter for industry-wide application. Indeed, any attempt to resolve these industry-wide issues on a case by case basis would have had significantly greater impact on individual pipelines.

Despite petitioners' attempt to fabricate new legal standards, the law requires only that substantial evidence support the essential elements of the Commis-

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[11] In its Order on Rehearing, the Commission specifically considered and addressed the arguments raised by the individual pipelines. Pet. App. E. This careful consideration of the individual circumstances of the pipelines satisfies any procedural rights due to them. Furthermore, while the Commission concluded that all minimum bills which recover variable costs are unjust and unreasonable, it also concluded that it would not eliminate fixed cost minimum bills on a generic basis. Pet. App. A-115. The Commission has continued to consider fixed cost minimum commodity bills on their individual merits. *E.g.*, Tennessee Gas Pipeline Co., 32 F.E.R.C. ¶ 61,311 (1985); Transwestern Pipeline Co., 32 F.E.R.C. ¶ 61,009 (1985).

sion's order. It must be stressed that, as well as ruling on the procedure followed by the Commission, the court of appeals specifically found that "each of the order's essential elements is supported by substantial evidence." Pet. App. A-42. The court of appeals found that the procedures adopted by the Commission produced an adequate record, specifically including substantial evidence to support each essential element of the Commission's decision. The capacity of procedures to produce substantial evidence, not the procedural method itself, is the relevant issue. As this Court has held, "Congress . . . . specified necessary components of the ultimate decision, but it did not specify the method by which the Commission should acquire information about these components." *United States v. Florida East Coast Ry. Co., supra,* 410 U.S. at 235.

The DOE Act specifically authorizes the use of rulemaking procedures in ratemaking matters. 42 U.S.C. § 7173(c) (1982). The court of appeals found that the essential elements of the Commission's decisions are supported by "substantial evidence", thereby satisfying the mandates of the NGA. Thus, the conclusion of the court of appeals that the "substantial evidence" standard of the NGA "does not dictate the procedure to be followed . . . . [but] has to do with a court's review of the adequacy *vel non* of the evidence relied upon to support a finding, whatever the kind of hearing," Pet. App. A-55 (citing *American Public Gas Association v. F.P.C.*, 567 F.2d 1016, 1067 (D.C. Cir. 1977)), was mandated by the decision of this Court in *Vermont Yankee*:

> [T]he adequacy of the "record" in this type of proceeding is not correlated directly to the type of procedural devices employed, but rather turns on whether the agency has followed the statutory

> mandate of the Administrative Procedure Act or other relevant statutes. . . In short, nothing in the APA, NEPA, the circumstances of this case, the nature of the issues being considered, past agency practice, or the statutory mandate under which the Commission operates permitted the court to review and overturn the rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the Commission so long as the Commission employed at least the statutory *minima*, a matter about which there is no doubt in this case.

Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., supra, 435 U.S. at 547-48.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted,

DAVID I. BLOOM *
MAYER, BROWN & PLATT
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 463-2000

ROBERT A. HELMAN
STEPHEN M. SHAPIRO
WENDELL H. ADAIR, JR.
MAYER, BROWN & PLATT
231 South LaSalle Street
Chicago, Illinois 60604

Attorneys for
Northern Illinois Gas Company

* Counsel of Record

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Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252.

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,
VS.
FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF RESPONDENT SOUTHERN CALIFORNIA GAS COMPANY IN OPPOSITION TO PETITIONERS

THOMAS D. CLARKE
E. R. ISLAND
MICHAEL D. GAYDA*
810 South Flower Street
Los Angeles, CA 90017
(213) 689-4255

Attorneys for Southern California Gas Company

* *Counsel of Record*

March 28, 1986

Bowne of Los Angeles, Inc., Law Printers. (213) 742-6600.

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission (Commission) has the authority under Section 5 of the Natural Gas Act to modify tariff provisions when the Commission finds that those tariff provisions have anti-competitive effects.

2. Whether the Commission's notice and comment procedures in a formal rulemaking proceeding satisfy the requirements of the Natural Gas Act.

3. Whether the Commission's finding that minimum commodity bill and minimum take provisions in tariffs have anti-competitive effects was supported by substantial evidence.

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Statute

Natural Gas Act, 15 U.S.C. §§ 717-717w (1982) . . *passim*

LIST OF PARENT, SUBSIDIARIES AND AFFILIATES

Southern California Gas Company (SoCalGas) is a wholly-owned subsidiary of Pacific Lighting Corporation. The following are the parent, subsidiaries and affiliates of SoCalGas:

Ankirk
Blackfield Hawaii Corporation
California LNG Company
Carmel Mountain Properties
Central Plants, Inc
Dual Fuel Systems, Inc.
Dunn Properties Corporation
Dunn Properties of Georgia, Inc.
Dunn Properties of Texas, Inc.
Fredericks Sales, Inc.
Fredricks Development Corporation
Fuel Industries New Zealand Limited
Hawaii Management Corporation
Mayflower Realty Associates, Inc.
Modular Products, Inc.
Nellie Gail Ranch Recreation Company
Pacific Alaska LNG Company
Pacific Center Downtown, Inc.
Pacific Energy Resources Incorporated
Pacific Gas Gathering Company
Pacific Geothermal Company
Pacific Hydropower Company
Pacific Indonesia LNG Company
Pacific Interstate Company
Pacific Interstate Mojave Company
Pacific Interstate Offshore Company
Pacific Interstate Transmission Company
Pacific Interstate Transmission Company (Arctic)

Pacific Lighting Bio-Energy Company
Pacific Lighting Capital Company N.V.
Pacific Lighting Commercial Loans, Inc.
Pacific Lighting Corporation
Pacific Lighting Energy Systems
Pacific Lighting Exploration Company
Pacific Lighting Gas Development (Canada) Ltd.
Pacific Lighting Gas Development Company
Pacific Lighting International Finance N.V.
Pacific Lighting Land Company
Pacific Lighting Leasing Company
Pacific Lighting Marine Company
Pacific Lighting Oil and Gas Company
Pacific Lighting Overseas Finance N.V.
Pacific Lighting Properties, Inc.
Pacific Lighting Real Estate Group
Pacific Lighting Securities Company
Pacific Offshore Pipeline Company
Pacific Oroville Power, Inc.
Pacific Synthetic Fuel Company
Presley ASW Finance Co., Inc.
Presley Chicago, Inc.
Presley Company East, Inc.
Presley Company of New Mexico
Presley Development Company of Arizona
Presley Financial Corporation
Presley-Home Mac Finance Co., Inc.
Presley of Northern California
Presley of San Diego
Presley of Southern California
Sabagli N.V.
S. M. Dunn, Inc.
SMA Development Corporation
Southern California Conservation Financing Company

Southern California Gas International Finance N.V.
Southern California Solar Financing Company
Terra Resources, Inc.
The Presley Companies
Western LNG Terminal Company
Western Power, Inc.

Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

In the Supreme Court

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OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

VS.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF RESPONDENT SOUTHERN CALIFORNIA GAS COMPANY IN OPPOSITION TO PETITIONERS

Respondent, Southern California Gas Company (SoCalGas),[1] respectfully requests that this Court deny the Petitions for Writ of Certiorari, seeking review of the District of Columbia Circuit Court of Appeals' opinion in this case. App. at 1.[2] This case involves no conflict between the Circuits, raises no Constitutional question, and

[1]SoCalGas and its affiliate, Pacific Lighting Gas Supply Company (PLGS), were parties below. Recently, SoCalGas and PLGS merged and are operating under the name of SoCalGas.

[2]The appendix references are to the appendix filed with this Court by Transwestern Pipeline Company.

involves no significant issue concerning the administration of the Natural Gas Act. 15 U.S.C. §§ 717-717w (1982).

STATEMENT OF THE CASE

This case involves the Federal Energy Regulatory Commission's (Commission) promulgation of a rule which eliminates non-incurred variable gas costs from the tariffs of interstate pipelines. Under the rule, the pipelines continue to collect, unchanged, the fixed costs in their tariffs. These fixed costs include the non-gas costs of a pipeline such as wages, operation and maintenance expenses, depreciation and return on rate base. The pipelines also continue to collect the gas costs which they incur for the gas they sell. However, pipelines can no longer bill and collect from their customers for gas costs which they do not incur.

The Commission has applied this rule to both minimum commodity bills and minimum take provisions. Minimum commodity bills require customers of pipelines to pay for minimum quantities of gas whether or not it is taken. Minimum take provisions are even more restrictive, requiring customers of pipelines to actually take a minimum quantity of gas whether or not they want it. Both of these minimum bill provisions severely restricted a customer's discretion in making purchases.

Six natural gas pipeline companies have filed Petitions with this Court to seek review of a unanimous decision of the Court of Appeals for the District of Columbia Circuit which affirmed the Commission's Orders in all respects, except one which is not a subject of these Petitions.[3]

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[3]Petitions have been filed by Transwestern Pipeline Company (Transwestern) (No. 85-1219); ANR Pipeline Company (ANR) (No. 85-1236); Texas Eastern Transmission Corporation (Texas Eastern)

Petitions for Rehearing were denied by the Court of Appeals, with no member requesting the taking of a vote on the Petitions. App. at 69, 70.

SoCalGas is a natural gas distribution company which provides natural gas service in southern and central California. SoCalGas is the largest natural gas distribution company in the country having more than 4.0 million customers and providing natural gas service to a population of approximately 13.0 million. SoCalGas purchases natural gas from a number of interstate pipeline companies including Transwestern Pipeline Company (Transwestern), one of the Petitioners before this Court.

Under the provisions in Transwestern's tariff, SoCalGas had the annual obligation to take or pay for 91 percent of a contract quantity of 750,000 Mcf of gas per day. Transwestern's tariff provisions also required that SoCalGas actually take from Transwestern, regardless of its need and regardless of the cost, on a daily basis, 80 percent of the contract quantity of 750,000 Mcf or 600,000 Mcf of gas. If SoCalGas did not need this volume of gas on a daily basis it was still required to take such volumes.

The Commission's Order Nos. 380, 380-A, 380-B, 380-C and 380-D[4] relieved SoCalGas of these severe tariff restrictions and allowed it to purchase gas based upon relative cost rather than these tariff provisions.[5]

(No. 85-1237); Trunkline Gas Company and Panhandle Eastern Pipeline Company (No. 85-1250); and Arkla Energy Resources (Arkla) (No. 85-1282).

[4]These orders are referred to in this brief as "Order No. 380."

[5]It should be noted that other provisions in Transwestern's tariff relieve Transwestern of the obligation to provide the contracted quantity of gas during periods when gas is unavailable. These tariff provisions which were placed in Transwestern's tariff long after Transwestern's contract was signed with SoCalGas were approved by

The Commission's intention of promoting competition among interstate pipelines in issuing Order No. 380 has had its desired effect. For example, Transwestern which at the time of the issuance of Order No. 380 was a higher priced supplier to SoCalGas, has, in response to competition generated by Order No. 380, become the low price leader of the suppliers to southern California.[6] As the result of discretionary actions which Transwestern has taken, it has significantly reduced its commodity rate to SoCalGas. The ratepayers of SoCalGas are the ultimate beneficiaries of this reduction.

REASONS WHY THE WRIT SHOULD BE DENIED

I

The Court's Decision Below Follows An Unbroken Line Of Authority In Finding That The Commission Acted Within Its Authority To Modify Tariffs And Contracts Under Section 5 Of The Natural Gas Act.

Petitioners here launch what the Court below termed a "barrage of attacks upon the Commission's authority to issue Order No. 380." App. at 25. The Commission's authority to act under Section 5 of the Natural Gas Act, 15 U.S.C. § 717d (1982), is so clear, and the arguments by

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the Commission and upheld by the Ninth Circuit Court of Appeals in *Pacific Lighting Service Co. v. FPC,* 518 F.2d 718 (9th Cir. 1975).

[6]Prior to the effective date of Order No. 380, Transwestern's commodity rate of $3.85/MMBtu was significantly higher than the $3.57/MMBtu commodity rate of El Paso Natural Gas Company (El Paso), which is Transwestern's major competitor in the southern California market. *Compare Transwestern Pipeline Co.*, 26 FERC ¶ 61,424 (1984) with *El Paso Natural Gas Co.*, 26 FERC ¶ 61,423 (1984). Currently Transwestern's commodity rate is $2.87/MMBtu compared to El Paso's current commodity rate of $2.98/MMBtu. *Compare Transwestern Pipeline Co.*, 34 FERC ¶ 61,201 (1986) with *El Paso Natural Gas Co.*, 34 FERC ¶ 61,171 (1986).

the Petitioners are so tenuous, that the Court below found that the Petitioners' claims concerning the Commission's authority to act were either "frivolous" or "completely without merit." App. at 25.

Simply put, an argument cannot credibly be made that the Commission exceeded its authority in issuing Order No. 380. Section 5 of the Natural Gas Act empowers the Commission upon finding "that any rate, charge, or classification . . . or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential" to determine the just and reasonable rate or contract and to fix that rate or contract by order. 15 U.S.C. § 717d(a). The Court below, in citing to this Court's decision in *Permian Basin Area Rate Cases*, 390 U.S. 747, 783-84 (1968), stated, "At any rate, Section 5 gives the Commission authority to alter terms of any existing contract found to be 'unjust' or 'unreasonable' ". App. at 25-26.

In fact, Petitioners acknowledge that the Commission is authorized under Section 5 of the Act to modify contracts and tariffs. *See* Transwestern's Petition at 9, Texas Eastern's Petition at 11. Petitioners cite no case which challenges the Commission's authority to modify tariffs or contracts. Instead, Petitioners argue that the Commission exceeded its authority because it did not fully consider the role of contracts under the Natural Gas Act or that the provisions of Order No. 380 destroy the mutuality of contracts. In essence, these arguments by Petitioners, while termed to be challenges to the statutory authority of the Commission to issue its Order, are in reality merely disagreements with the Commission's weighing of the various factors which were considered in issuing its decision. The role of this Court is not to weigh the individual factors in evidence but to defer to the

expertise of the administrative agency in considering the evidence before it. *Permian Basin,* 390 U.S. 747 (1968).

II

The Court's Decision Below Does Not Raise Certain Of The Questions Presented In The Petitions.

Petitioners have raised for review certain issues which were not the holding in the decision of the Court below. First, Petitioners question if the Commission is authorized to abrogate a settlement agreement which was previously approved by the Commission. Second, Petitioners question if the Commission is authorized to modify or revoke a certificate of public convenience and necessity issued under Section 7 of the Natural Gas Act, 15 U.S.C. § 717f (1982). The District of Columbia Circuit Court of Appeals either did not decide these issues or did not base its decision upon such finding. Moreover the facts below indicate there was no violation of a settlement or revocation of a certificate.

A Petitioner, ANR, contends that the Commission has exceeded its statutory authority by abrogating a settlement agreement to which the Commission was a party. The District of Columbia Circuit however did not decide this issue. The Court below stated, "We find that Order No. 380 does not violate any term of either Transco's or ANR's settlement. We therefore do not reach the issue of whether the Commission has the statutory authority to abrogate settlement agreements to which it is a party through a generic section 5 rulemaking." App. at 26.

Moreover, the record in this proceeding does not permit the formulation of a resolution of this question presented by the Petitioner. The underlying settlement merely provides that the minimum bill issue shall be set for hearing in Docket No. RP82-80. (ANR attachment I at

B-1). In discussing this settlement the Court below found that the Commission was not restricted in dealing with ANR's minimum bill in an ongoing rulemaking. The Court stated, "As it is written, however, the agreement neither binds the Commission to resolve the issues in ANR's ratemaking proceeding nor exempts ANR's minimum bill provisions from the general rulemaking in progress. We conclude, therefore, that by issuing Order No. 380 the Commission did not violate the terms of the settlement agreement." App. at 29.

Petitioners, Transwestern and Arkla, claim that the Commission was without authority to revoke or modify certificates of public convenience and necessity granted under Section 7 of the Natural Gas Act. 15 U.S.C. § 717f. While the Court found that the Commission did have the authority to modify certificates, its holding was not based upon this finding. The Court below, citing this Court's decision in *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 389 (1959), found that Section 7 of the Natural Gas Act does not guarantee a recipient of a certificate that the initial terms of the certificate will never be changed. The Commission has the authority under Section 5 of the Natural Gas Act, 15 U.S.C. § 717d, to alter and amend terms and conditions of certificated service. *Pacific Gas Transmission Co. v. FPC*, 536 F.2d 393 (D.C. Cir. 1976), *cert. denied*, 429 U.S. 999 (1976). In fact, once the Commission determines a term or condition is unjust and unreasonable it must remedy the situation. *American Smelting and Refining Co. v. FPC*, 494 F.2d 925 (D.C. Cir. 1974), *cert. denied*, 419 U.S. 882 (1974); *Pacific Gas Transmission Co. v. FPC*, 536 F.2d 393 (D.C. Cir. 1976).

The decision of the Court below would not change even if its determination is incorrect since the Court found that the Commission's decision did not revoke or modify

the Section 7 certificates of Petitioners. The Court stated:

> Even assuming *arguendo* that the Commission has no authority to amend or revoke certificated service in a Section 5 proceeding, the elimination of minimum bills has no effect on the pipelines *authorized* service. The Order merely addresses the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to Section 5.

App. at p. 25, n.9 (emphasis in original). Thus, the issues which Petitioners have asked this Court to review are simply not material to the decision of the Court below.

III

As The Court Below Found, The Commission Utilized The Proper Procedures And Therefore There Is No Reason For This Court To Grant The Writ For Certiorari.

Petitioners argue that the rulemaking procedures used by the Commission in this case were insufficient to satisfy the hearing requirement of Section 5 of the Natural Gas Act. The statutory requirement for a hearing can be satisfied through either a rulemaking proceeding or an adjudicatory proceeding. *SEC v. Chenery Corp.*, 332 U.S. 194 (1947); *Phillips Petroleum Co. v. FPC*, 475 F.2d 842 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974). In this case, the Commission within its discretion, utilized its rulemaking procedures. The Court below found that the Commission's decision to proceed through rulemaking, "clearly passes muster under our deferential standard of review." App. at 51. *See, FPC v. Transcontinental Gas Pipeline Corp.*, 423 U.S. 326, 333 (1976).

The use of notice and comment procedures by the Commission was an appropriate method to acquire information on an industry-wide problem. *See, United States v.*

Florida East Coast Ry. Co., 410 U.S. 224, 245 (1973). The fact that 95 parties submitted over 1,000 pages of comments in response to the Commission's first notice of proposed rulemaking indicates that the Commission's proposed rulemaking was not a matter that uniquely or exceptionally affected only a few parties. A review of the two series of comments and reply comments filed with the Commission reveals that all sectors of the natural gas industry took the opportunity to make their views known and address the arguments raised by other parties.

The repeated notices and comments which characterize this proceeding demonstrate the thorough procedures used by the Commission. As this Court has stated, and as noted by the Court below, App. at 54, nothing permits "the court to review and overturn the rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the Commission so long as the Commission employed at least the statutory minima." *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519, 548 (1978). There is no doubt that the Commission has done so here.

IV

The Court's Decision Below Gave Full Consideration To The Issues And Determined That The Commission's Decision Was Based Upon Substantial Evidence.

Petitioners raise a wide-range of issues which, in essence, challenge the reasonableness of the Commission's Order. Pursuant to Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b), the standard which is to be used by a Court in reviewing the Commission's factual findings is that of substantial evidence. *Public Service Commission of the State of NewYork v. FERC*, 642 F.2d 1335 (D.C. Cir. 1980), *cert. denied*, 454 U.S. 879 (1981). The factual findings of the Commission are to be considered conclu-

sive if supported by substantial evidence. In this regard the Court is not to substitute its view of the facts for that of the Commission. *Colorado Interstate Gas Co. v. FPC*, 142 F.2d 943 (10th Cir. 1944), *aff'd.*, 324 U.S. 581 (1945), *reh'g denied*, 325 U.S. 891 (1945).

The Commission's examination of all aspects of this rule can only be described as overwhelming and conclusive. In fact, the reviewing Court below has so found. The Court's conclusion is illustrative in describing the breadth of the Commission's review where it states,

> In sum, we find that each of the order's essential elements is supported by substantial evidence. Since we have assured ourself "that the Commission has given reasoned consideration to each of the pertinent factors", it is not our province "to supplant the Commission's balance of these interests with one more merely to [our] liking", *Permian Basin*, 390 U.S. at 792.

App. at 42.

Thus, Petitioners' claims simply do not merit review by this Court.

CONCLUSION

For these reasons, the Petitions for a Writ of Certiorari should be denied.

Respectfully submitted,

THOMAS D. CLARKE
E. R. ISLAND
MICHAEL D. GAYDA
810 South Flower Street
Los Angeles, California 90017
Attorneys for Respondent
Southern California Gas
Company

March 28, 1986

Supreme Court, U.S.
FILED
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Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF CONSUMERS POWER COMPANY, *ET AL.*, IN OPPOSITION TO PETITIONS FOR WRIT OF CERTIORARI

WM. WARFIELD ROSS
Counsel of Record
JERRY D. ANKER
DANIEL L. KOFFSKY
JANET M. ROBINS
WALD, HARKRADER & ROSS
1300 Nineteenth Street, N.W.
Washington, D.C. 20036
(202) 828-1200
Attorneys for
Consumers Power Company

March 28, 1986

[Additional Counsel Listed on Inside Cover]

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

JEFFREY M. PETRASH
JAMES H. HOLT
DICKINSON, WRIGHT, MOON, VAN DUSEN & FREEMAN
1901 L Street, N.W.
Washington, D.C. 20036
Attorneys for Michigan Consolidated Gas Company

PAUL E. GOLDSTEIN
PAUL W. MALLORY
701 East 22d Street
P.O. Box 1207
Lombard, Illinois 60148
Attorneys for Natural Gas Pipeline Company of America

JAMES HINCHLIFF
THOMAS M. PATRICK
KAREN CARGILL
122 South Michigan Avenue
Suite 320
Chicago, Illinois 60603
Attorneys for The Peoples Gas Light and Coke Company

EDWARD J. GRENIER, JR.
GLEN S. HOWARD
SUTHERLAND, ASBILL & BRENNAN
1666 K Street, N.W.
Washington, D.C. 20006
Attorneys for American Iron and Steel Institute and Process Gas Consumers Group

BRIAN J. MOLINE
DANA GORMAN
4th Floor
State Office Building
Topeka, Kansas 66612
Attorneys for Kansas Corporation Commission

MARY E. BALUSS
MORGAN, LEWIS & BOCKIUS
1800 M Street, N.W.
Washington, D.C. 20036
Attorney for Inter-City Gas Corporation

RICHARD M. MERRIMAN
JOHN R. SCHAEFGEN, JR.
STEPHEN L. HUNTOON
REID & PRIEST
1111 19th Street, N.W.
Washington, D.C. 20036
Attorneys for Michigan Gas Utilities Company

FRANK J. KELLEY
Attorney General
LOUIS J. CARUSO
Solicitor General
R. PHILIP BROWN
DON L. KESKEY
Ass't Attorneys General
Suite 11
1000 Long Boulevard
Lansing, Michigan 48910
Attorneys for State of Michigan and Michigan Public Service Commission

JANICE E. KERR
J. CALVIN SIMPSON
MICHAEL B. DAY
State Building
Room 5240A
350 McAllister Street
San Francisco, CA 94102
Attorneys for the Public Utilities Commission of the State of California

GLENN W. LETHAM
GOLDBERG, FIELDMAN & LETHAM, P.C.
1100 15th Street, N.W.
Washington, D.C. 20005
Attorney for Chattanooga Gas Company, a Division of Jupiter Industries, Inc.

STEPHEN J. SMALL
RICHARD L. GOTTLIEB
P.O. Box 1273
Charleston, WV 25325
Attorneys for Columbia Gas Transmission Corporation

HENRY P. SULLIVAN
JAMES L. BLASIAK
4 Gateway Center
Pittsburgh, PA 15222

DAVID E. WEATHERWAX
STEPHEN E. WILLIAMS
GEORGIA B. CARTER
445 West Main Street
Clarksburg, WV 26301

MARK G. MAGNUSON
1101 16th Street, N.W.
Washington, D..C 20036

Attorneys for Consolidated Gas Transmission Corporation

MICHAEL W. HALL
GARY E. GUY
CULLEN & DYKMAN
1019 19th Street, N.W.
Washington, D.C. 20036

Attorneys for Brooklyn Union Gas Company

RICHARD A. SOLOMON
WILNER & SCHEINER
1200 New Hampshire Ave., N.W.
Washington, D.C. 20036

Attorney for Public Service Commission of the State of New York

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BRIEF OF CONSUMERS POWER COMPANY, *ET AL.*, IN OPPOSITION TO PETITIONS FOR WRIT OF CERTIORARI

INTRODUCTION

Respondents Consumers Power Company, Michigan Consolidated Gas Company, Natural Gas Pipeline Company of America, the Peoples Gas Light and Coke Company, American Iron and Steel Institute, Process Gas Consumers Group, Kansas Corporation Commission, Inter-City Gas Corporation, Michigan Gas Utilities Company, State of Michigan, Michigan Public Service Commission, Public Utilities Commission of the State of

California, Chattanooga Gas Company, a Division of Jupiter Industries, Inc., Columbia Gas Transmission Corporation, Consolidated Gas Transmission Corporation, Brooklyn Union Gas Company, and Public Service Commission of the State of New York file this brief in opposition to the petitions for certiorari in the above-captioned cases.[1]

STATEMENT OF THE CASE

This case involves orders issued by the Federal Energy Regulatory Commission (FERC or Commission), after extensive rulemaking proceedings, pursuant to provisions of the Natural Gas Act, 15 U.S.C. §§ 717-717w (1982). The orders (the Order No. 380 series) prohibited interstate natural gas pipelines from imposing either (a) "minimum commodity bills" that require customers to pay for "variable costs"[2] with respect to minimum volumes of gas they do not actually purchase, or (b) "minimum take" provisions that require the purchase and receipt of specified volumes of gas.[3] Five natural gas pipeline companies have filed petitions for certiorari, seeking review of the unanimous decision of the United States Court of Appeals for the District of Columbia Circuit (Judges Tamm, Mikva, and Starr) that upheld those orders in all pertinent respects. The Court of Appeals also denied rehearing and rehearing en banc, with no member of the court requesting a vote for an en banc hearing.

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[1] A list of these respondents' parents, affiliates, and subsidiaries that are not wholly-owned is attached as an appendix to this brief.

References in the form "A.——" are to the Appendix to the Petition for a Writ of Certiorari filed by Transwestern Pipeline Company in No. 85-1219.

[2] These "costs" typically included payment of the pipeline's purchase price of gas, even if it was not acquired by the pipeline and delivered through the pipeline's system.

[3] The respondents have addressed in this brief only minimum bill, rather than minimum take, provisions.

The orders at issue represent an exercise of the FERC's authority and responsibility to conform its policies to new legislation and the shifting requirements of the public interest. In its initial notice of proposed rulemaking, the FERC noted a number of developments since the enactment in 1978 of the Natural Gas Policy Act (NGPA), 15 U.S.C. §§ 3301-3432 (1982), that changed the role and significance of minimum bills and demonstrated the need for a comprehensive reevaluation of those provisions. (A-79 to A-81.) The NGPA represented a fundamental departure from the previous statutory scheme governing prices paid for natural gas at the point of its production, i.e., at the wellhead. It established "a new system of natural gas pricing . . . needed to balance supply and demand." *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board of Mississippi*, 106 S. Ct. 709, 716 (1986). Under this regime, which calls for gradual deregulation of the wellhead prices for some categories of gas, "[t]he new federal role is to 'overse[e] a national market price regulatory scheme.'" *Id.* (citation omitted).

The FERC noted that the effectiveness of the NGPA's new market-based scheme of gas pricing was being significantly impeded by the presence of minimum bill provisions, which effectively compelled customers to purchase or pay for a predetermined volume of gas from a particular supplier, without regard to the price of or need for that gas. The FERC found that the economic roles of supply, demand, and price were undermined when a customer's purchases from a pipeline were dictated by a factor unrelated to the need for the gas or the availability of alternate supplies at a more favorable price. The FERC (without reference to antitrust law or analysis) characterized this feature of minimum bills as potentially anticompetitive and found the recovery of gas purchase costs (as well as other variable costs) through minimum bill provisions to be unjust and un-

reasonable and thus contrary to the requirements of the Natural Gas Act. (A-82 to A-85.)

The FERC also noted that the overall supply and demand characteristics of the industry had changed significantly since the passage of the NGPA. The NGPA permitted producers to charge higher, "incentive" prices for gas at the wellhead, and in response to these higher prices significant incremental supplies of gas became available. Roughly coincident with this increase of supply, a series of factors—conservation, a decline in worldwide petroleum prices, and the economic recession of the early 1980s—dramatically reduced the nationwide demand for gas. These countervailing trends—increasing natural gas supplies and diminishing demand for gas—left many pipeline customers without adequate markets for the gas they were required to purchase or pay for under their minimum bills. Under such circumstances, a pipeline that received payment for gas not purchased could "recover" costs that it did not incur and obtain windfall profits.[4] The Commission found that minimum bills operating in this fashion are unjust and unreasonable. (A-82 to A-85.)

Although many parties in the rulemaking had urged the total elimination of minimum bills, the FERC limited its orders to preclude only the recovery of variable costs through minimum bills. The Commission declined in the rulemaking to prohibit the recovery of fixed costs by pipelines through minimum bill provisions or customer demand charges.[5] Fixed costs are, by regulatory

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[4] Consumers Power Company, for example, estimated that it would have faced $250 million of minimum bill penalties to Trunkline Gas Company in the absence of a short-term settlement of a litigated proceeding before the FERC in 1983. (A-82.)

[5] For a description of the manner in which demand charges and commodity charges are structured under a typical two-part rate for pipeline sales service, see A-71 to A-73.

definition, those costs incurred by a pipeline whether it purchases and sells gas or not.

Noting the limited nature of its action, the Commission rejected the argument that the prohibition of variable-cost minimum bills amounted to a "restructuring" of the gas industry because it would relieve customers of the obligation to purchase gas without relieving pipelines of the obligation to provide service upon demand. The FERC observed that this argument overlooks that Order No. 380 permits a pipeline to continue to recover fixed costs through the operation of demand charges, which customers pay "whether or not they buy gas." (A-93.)

The Commission specifically addressed concerns about so-called "take-or-pay" provisions in pipeline-producer contracts under which pipelines undertake to prepay producers for a minimum quantity of gas over a specified period. To the extent that such prepayments are not satisfied by the pipeline's ultimate receipt of the prepaid gas, they may generate costs. The Commission noted that a pipeline may seek to recover such costs from its customers, if the pipeline in fact incurs them (A-77 to A-78), and Order No. 380 permits pipelines to continue to recover any such take-or-pay costs that are prudently incurred. The Commission also explained that the difficult issues pertinent to the distribution of prepayment costs among a pipeline's customers would be addressed in individual pipeline rate cases. (A-102 to A-107.)

The FERC's orders have had an immediate, concrete, and beneficial impact on the millions of consumers of gas nationwide, by precluding natural gas pipeline companies from charging their customers for gas that they did not purchase and costs that the pipelines did not incur. Order No. 380 has saved consumers millions of dollars, as the rulemaking record compiled before the FERC demonstrated it would. The Commission's actions

were essential to the administration of the Natural Gas Act, the purpose of which is "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388 (1959).

ARGUMENT

The petitions for writs of certiorari raise a multitude of issues. However, there is no conflict among the circuits with respect to any of the issues raised, and none of the issues is of sufficient importance to warrant this Court's review.

1. Petitioners contend that the Commission's orders endanger pipeline recovery of fixed costs and threaten to shift those costs to full requirements customers. The Commission specifically addressed these issues. The rule permits continued recovery of fixed costs through a minimum bill. Furthermore, customers remain obligated to pay all the fixed costs assigned to the demand and commodity components of a pipeline's rate. The Commission's action, therefore, protects full requirements customers and pipelines from bearing the cost of facilities constructed for customers that reduce their purchases below minimum bill levels.

2. There is also no basis for petitioners' claim that it was unreasonable for the Commission to decline to eliminate take-or-pay provisions in producer-pipeline contracts at the same time it eliminated variable-cost minimum bills. Petitioners argue that the two types of provisions are inextricably linked. They assert that, without the requirement to pay for variable costs in minimum bills, partial requirements customers will be able to switch more easily from their traditional pipeline suppliers to lower-cost pipelines, and the traditional suppliers will then be unable to meet their take-or-pay obligations.

The Commission gave considerable attention to this issue and concluded that "there is no clear nexus between a pipeline's annual take-or-pay obligations and its minimum commodity bills to its customers." (A-103.)[6] Reductions in purchases by any specific customer or group of customers will not necessarily result in increased pipeline take-or-pay liabilities to producers. For example, purchases by other customers may more than compensate for reductions in sales by partial requirements customers. In addition, most take-or-pay contracts contain make-up provisions that allow the pipeline to credit its take-or-pay payments against subsequent gas purchases that exceed take-or-pay levels, and make-up gas should be paid for by the customers that actually buy it and not by other customers that earlier reduced their purchases. (A-102 to A-105.) In any event, to the extent a pipeline incurs any take-or-pay costs,[7] the Commission's orders do not, as petitioners suggest, obligate full requirements customers to bear such costs, even in the short term. The rule leaves the allocation of any take-or-pay costs that are actually incurred for decision in the individual rate proceedings in which pipelines seek recovery of such costs. In those proceedings, the Com-

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[6] The Commission in any event was not legally required to resolve issues involving producer take-or-pay contracts at the same time it issued Order Nos. 380 and 380-A. As the court below found, "[a]n agency should not be paralyzed by having to decide all relevant issues at the same time. The agency's decision should be upheld unless the agency 'abuse[s] this flexibility by failing to consider . . . an issue whose resolution might seriously undercut the . . . rationale for its final action' . . . ." *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1159 (D.C. Cir. 1985) (citations omitted).

[7] The Commission acknowledged that initially there might be some cost shifting or take-or-pay cost increases on systems that lose partial requirements customers to other suppliers. It explained, however, that such shifts would be short-term and that all pipeline customers would benefit in the long term "as the industry moves towards a competitive balance." (A-99.)

mission can allocate such costs in a variety of ways. If the costs were not prudently incurred, the pipeline must bear them. If there is no finding of imprudence, the Commission could allocate costs to those customers that reduced their purchases, to those that switched to other suppliers, or to all customers. The Commission will also be free to develop other just bases for assigning such costs.

3. In their petition, Trunkline Gas Company and Panhandle Eastern Pipe Line Company have raised for the first time an argument that the Commission's orders conflict with the principles of the Natural Gas Policy Act (NGPA), by subjecting producer prices to market pressures (rather than only encouraging those prices to rise) and by interfering with the statutory mechanism for the pass-through of those prices. They did not raise this argument in the Court of Appeals at all and referred to it only fleetingly in their petition for rehearing before the Commission. Contrary to their arguments, the NGPA clearly contemplates that producer prices should be subject to market forces. *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board of Mississippi*, 106 S. Ct. 709, 716 (1986) (citing Sen. Rep. No. 95-436, at 10 (1977) ("new federal role is to 'oversee[e] a national price regulatory scheme' ")).[8]

4. There is no merit to petitioners' challenges to the rulemaking procedures that the Commission used in this

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[8] They also argue, more generally, that the Commission's orders promote head-to-head competition, in violation of principles of public utility regulation. However, the FERC's orders do not imperil recovery of fixed costs and thus retain significant protections from the allegedly adverse effects of competition. Moreover, the Natural Gas Act was not intended to prevent all competition among pipelines. Section 7 of the Act, by its terms, provides that the grant of a certificate does not confer a monopoly. 15 U.S.C. § 717f (1982). *See Northern Natural Gas Co. v. FPC*, 399 F.2d 953, 959-61 (D.C. Cir. 1968).

case. Order No. 380 was issued pursuant to Section 5 of the Natural Gas Act, which authorizes the FERC to act "after a hearing." 15 U.S.C. § 717d (1982). This Court has held that informal rulemaking procedures may satisfy the requirement of a ratemaking hearing, *United States v. Florida East Coast Railway*, 410 U.S. 224, 241-42 (1973), and has consistently affirmed the authority of the FERC to establish rates on a nationwide basis through the use of informal rulemaking procedures. *FPC v. Texaco, Inc.*, 377 U.S. 33, 39-45 (1964); *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

In the Department of Energy Organization Act of 1977, Congress expressly sanctioned the FERC's use of informal rulemaking procedures for any ratemaking function set forth in the Natural Gas Act. 42 U.S.C. § 7173(c) (1982). Pursuant to that provision, the FERC need only "assure full consideration of the issues and an opportunity for interested persons to present their views." The proceeding leading to Order No. 380 comprised two rounds of written comments by interested parties. Ninety-five parties filed initial comments by September 29, 1983. On January 25, 1984, the Commission invited interested parties to file reply comments by February 13, 1984; thirty parties filed such comments. The Commission issued Order No. 380 on May 25, 1984. The FERC issued Order No. 380-A on July 30, 1984, in response to requests for rehearing, stay, or clarification filed by twenty-five parties.

No party demonstrated to the Court of Appeals that it had not been afforded full opportunity to present its views. The FERC and the Court of Appeals applied proper procedural standards, and there is no reason for this Court to review those standards. *See Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519 (1978).

The enormity of the problem facing pipeline customers and consumers had been made abundantly clear to the Commission by the time it issued the orders involved here. Distributors, consumer groups, and pipelines that bought gas from other pipelines had repeatedly challenged minimum bills, beginning in 1981. In all, twenty-four proceedings before the Commission had raised a minimum bill issue. Virtually every pipeline using minimum commodity bills was challenged. It was appropriate—indeed necessary—for the Commission finally to address and resolve this industry-wide problem on an industry-wide basis.

5. Petitioner ANR Pipeline Company (ANR) contends that the Court of Appeals' ruling upheld the authority of the FERC to abrogate the terms of settlement agreements that it has previously approved. The Court of Appeals, however, made no such ruling. As ANR itself notes in its Petition for Certiorari at 15, the Court of Appeals merely determined that the terms of the particular settlement agreement cited by ANR did not preclude the FERC from applying Order No. 380 to ANR. This narrow issue does not warrant review by this Court.

CONCLUSION

For the reasons stated, the petitions for a writ of certiorari should be denied.

Respectfully submitted,

WM. WARFIELD ROSS
Counsel of Record
JERRY D. ANKER
DANIEL L. KOFFSKY
JANET M. ROBINS
WALD, HARKRADER & ROSS
1300 Nineteenth Street, N.W.
Washington, D.C. 20036
(202) 828-1200
Attorneys for
Consumers Power Company

JEFFREY M. PETRASH
JAMES H. HOLT
DICKINSON, WRIGHT, MOON, VAN DUSEN & FREEMAN
1901 L Street, N.W.
Washington, D.C. 20036
Attorneys for Michigan Consolidated Gas Company

PAUL E. GOLDSTEIN
PAUL W. MALLORY
701 East 22d Street
P.O. Box 1207
Lombard, Illinois 60148
Attorneys for Natural Gas Pipeline Company of America

JAMES HINCHLIFF
THOMAS M. PATRICK
KAREN CARGILL
122 South Michigan Avenue
Suite 320
Chicago, Illinois 60603
Attorneys for The Peoples Gas Light and Coke Company

EDWARD J. GRENIER, JR.
GLEN S. HOWARD
SUTHERLAND, ASBILL & BRENNAN
1666 K Street, N.W.
Washington, D.C. 20006
Attorneys for American Iron and Steel Institute and Process Gas Consumers Group

BRIAN J. MOLINE
DANA GORMAN
4th Floor
State Office Building
Topeka, Kansas 66612
Attorneys for Kansas Corporation Commission

MARY E. BALUSS
MORGAN, LEWIS & BOCKIUS
1800 M Street, N.W.
Washington, D.C. 20036
Attorney for Inter-City Gas Corporation

RICHARD M. MERRIMAN
JOHN R. SCHAEFGEN, JR.
STEPHEN L. HUNTOON
REID & PRIEST
1111 19th Street, N.W.
Washington, D.C. 20036
Attorneys for Michigan Gas Utilities Company

FRANK J. KELLEY
Attorney General
LOUIS J. CARUSO
Solicitor General
R. PHILIP BROWN
DON L. KESKEY
Ass't Attorneys General
Suite 11
1000 Long Boulevard
Lansing, Michigan 48910
Attorneys for State of Michigan and Michigan Public Service Commission

JANICE E. KERR
J. CALVIN SIMPSON
MICHAEL B. DAY
State Building
Room 5240A
350 McAllister Street
San Francisco, CA 94102
Attorneys for the Public Utilities Commission of the State of California

GLENN W. LETHAM
GOLDBERG, FIELDMAN & LETHAM, P.C.
1100 15th Street, N.W.
Washington, D.C. 20005
Attorney for Chattanooga Gas Company, a Division of Jupiter Industries, Inc.

STEPHEN J. SMALL
RICHARD L. GOTTLIEB
P.O. Box 1273
Charleston, WV 25325
Attorneys for Columbia Gas Transmission Corporation

HENRY P. SULLIVAN
JAMES L. BLASIAK
4 Gateway Center
Pittsburgh, PA 15222

DAVID E. WEATHERWAX
STEPHEN E. WILLIAMS
GEORGIA B. CARTER
445 West Main Street
Clarksburg, WV 26301

MARK G. MAGNUSON
1101 16th Street, N.W.
Washington, D..C 20036

Attorneys for Consolidated Gas Transmission Corporation

MICHAEL W. HALL
GARY E. GUY
CULLEN & DYKMAN
1019 19th Street, N.W.
Washington, D.C. 20036

Attorneys for Brooklyn Union Gas Company

RICHARD A. SOLOMON
WILNER & SCHEINER
1200 New Hampshire Ave., N.W.
Washington, D.C. 20036

Attorney for Public Service Commission of the State of New York

March 28, 1986

APPENDIX

APPENDIX

LIST OF RESPONDENTS' PARENTS, AFFILIATES, AND SUBSIDIARIES THAT ARE NOT WHOLLY-OWNED

Columbia Gas Transmission Corporation

Big Marsh Oil Company
Columbia Coal Gasification Corporation
Columbia Gas Development of Canada Ltd.
Columbia Gas Development Corporation
Columbia Gas of Kentucky, Inc.
Columbia Gas of Maryland, Inc.
Columbia Gas of New York, Inc.
Columbia Gas of Ohio, Inc.
Columbia Gas of Pennsylvania, Inc.
Columbia Gas of Virginia, Inc.
Columbia Gas System Service Corporation
Columbia Gulf Transmission Corporation
Columbia Hydrocarbon Corporation
Columbia LNG Corporation
Columbia Natural Resources, Inc.
Commonwealth Gas Pipeline Corporation
Commonwealth Gas Services, Inc.
Commonwealth Propane, Inc.
Inland Gas Company, Inc.
TriStar Gas Marketing, Inc. (pending SEC approval)

Consolidated Gas Transmission Corporation

Consolidated Natural Gas Company
The East Ohio Gas Company
The Peoples Natural Gas Company
Hope Gas, Inc.
CNG Producing Company
CNG Development Company
Consolidated System LNG Company
CNG Coal Company
CNG Research Company
West Ohio Gas Company

River Gas Company
CNG Energy Company
Consolidated Natural Gas Service Company, Inc.

Inter-City Gas Corporation

EKW Appliances, Inc.
Greater Winnipeg Gas Corporation
ICG Scotia Gas Ltd.
Keeprite, Inc.
Roam Communications Limited
The Mortgage Insurance Company of Canada
Vancouver Island Gas Company

Michigan Consolidated Gas Company

Primark Corporation

Michigan Gas Utilities Company

Michigan Energy Resources Company

Natural Gas Pipeline Company of America

Natural Gas Pipeline Company of America is a subsidiary of MidCon Corp., a majority of whose shares are owned by Occidental Petroleum Corporation.

MidCon Corp. is the parent of the following subsidiaries:

Alabama Gulf South Pipeline Company, Inc.
Alabama Methane Production Company
Anthrust, Inc.
Cotton Petroleum Corporation
Exeter Capital Corporation
Exeter Drilling Company
Exeter Exploration Company
Exeter Service Company
Gulf South Pipeline Company
Harper Oil Company
Lynx Drilling Company

MCN Acadian Gas Pipeline Corp.
MCN Bayou Interstate Pipeline Corp.
MCN Calcasieu Gas Gathering Corp.
MCN Coal Gasification Company
MCN Equities, Inc.
MCN Louisiana Industrial Gas
MCN Overseas Inc.
MCN Pelican Interstate Gas Corp.
MCN Pelican Transmission Corp.
MCN Pontchartrain Natural Gas Corp.
MCN Research, Inc.
MCN Spindletop Gas Distribution Corp.
MCN Technologies, Inc.
MCN Transmission, Inc.
MCN Utah Pipeline Corp.
MCN-TEX Corp.
MCN-Trinidad and Tobago LNG Company
MidCon Arkansas Pipeline Corp.
MidCon Colorado Pipeline Corp.
MidCon Acquisition Corp.
MidCon Enterprises, Inc.
MidCon Exploration Company
MidCon Gas Products, Inc.
MidCon General, Inc.
MidCon Holding Corp.
MidCon Hydrocarbons Corp.
MidCon Illinois Pipeline Corp.
MidCon International N.V.
MidCon Louisiana Pipeline Corp.
MidCon Michigan Pipeline Corp.
MidCon Mississippi Natural Gas Pipeline Corp.
MidCon Missouri Pipeline Corp.
MidCon Nebraska Pipeline Corp
MidCon New Mexico Pipeline Corp.
MidCon Oklahoma Natural Gas Pipeline Corp.
MidCon Plants, Inc.
MidCon Razorback Pipeline Corp.
MidCon Sales Inc.

MidCon Texas Pipeline Corp.
MidCon Ventures, Inc.
MidCon Wyoming Pipeline Corp.
MidOk Pipeline Company
MidTex Pipeline Company
Mississippi Gulf South Transmission Company
Mississippi River Transmission Corporation
NAERCO, Inc.
NGP-LNG, Inc.
Petrounited, Inc.
South Gulf Management, Inc.
TPC Pipeline Company
Texas Gulf South Pipeline Company
Texoma Production Company
Troy Potter Inc.
UER Gas Trading, Inc.
UER Marketing Company
UER Overseas Finance, N.V.
UER Services, Inc.
United Energy Resources, Inc.
United Energy Services Company
United Gas Pipe Line Company
United Texas Transmission Company
Western Energy Transport Company

The Peoples Gas Light and Coke Company

People's Energy Corporation

Process Gas Consumers Group

American Standard, Inc.
Armco, Inc.
Bethlehem Steel Corporation
Carpenter Technology Corporation
Cone Mills Corporation
Corning Glass Works
General Motors Corporation
Owens-Corning Fiberglas Corporation
Owens-Illinois, Inc.

(8) (5) (5) (5) (6)

Nos. 85-1219, 85-1236, 85-1237, 85-1250, and 85-1252

In the Supreme Court of the United States

OCTOBER TERM, 1985

Supreme Court, U.S.
FILED
APR 29 1986
JOSEPH F. SPANIOL, JR.
CLERK

TRANSWESTERN PIPELINE CO., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ANR PIPELINE CO., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

TEXAS EASTERN TRANSMISSION CORP., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

TRUNKLINE GAS CO. AND
PANHANDLE EASTERN PIPE LINE CO., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ARKLA ENERGY RESOURCES, ETC., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

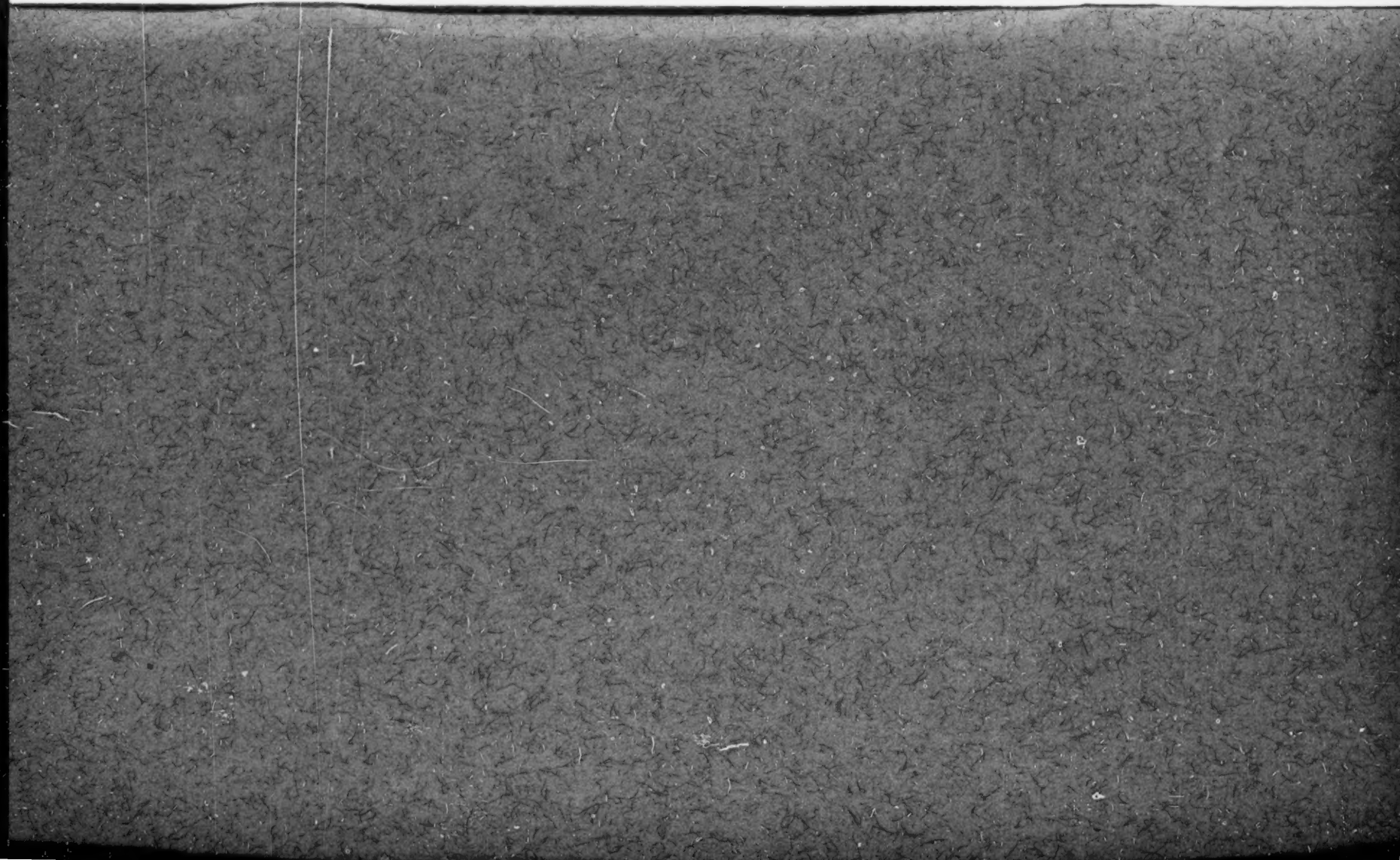
WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

A. KAREN HILL
Attorney
Federal Energy Regulatory Commission
Washington, D.C. 20426

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

28 pp



QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission reasonably exercised its statutory authority to regulate natural gas pipeline rates by adopting a rule requiring pipelines to eliminate from their tariffs "minimum bill" provisions that permit a pipeline to charge a customer for the variable costs associated with a specified volume of gas even if the customer does not actually take delivery of the gas from the pipeline.

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OCTOBER TERM, 1985

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BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A56) is reported at 770 F.2d 1144.[1] The orders of the Federal Energy Regulatory Commission (Pet. App. A71-A128, A129-A225, A226-A230, A231-A270, A271-A279) are reported at 27 F.E.R.C. ¶ 61,318; 28 F.E.R.C. ¶ 61,175; 29 F.E.R.C. ¶ 61,076; 29 F.E.R.C. ¶ 61,077; and 29 F.E.R.C. ¶ 61,332.

JURISDICTION

The judgment of the court of appeals (Pet. App. A57-A68) was entered on August 20, 1985, and petitions for rehearing were denied on October 25, 1985 (Pet. App. A69-A70). The petition for a writ of certiorari in No. 85-1219 was filed on January 21, 1986; the petitions in Nos. 85-1236 and 85-1237

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[1] "Pet. App." refers to the appendix to the petition in No. 85-1219.

were filed on January 22, 1986; and the petitions in Nos. 85-1250 and 85-1252 were filed on January 23, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Natural Gas Act, 15 U.S.C. 717 *et seq.*, empowers the Federal Energy Regulatory Commission to regulate the rates charged by natural gas pipelines for sales of natural gas. This case involves a rule promulgated by the Commission pursuant to this statutory authority; the Commission barred natural gas pipelines from using "minimum commodity bills" to charge their customers for the variable costs associated with a specified volume of gas whether or not the customer takes delivery of that much gas. The Commission also prohibited the use of similar tariff and contract provisions requiring a customer to take physical delivery of a specified amount of gas.

a. The rates charged by natural gas pipelines generally consist of two basic components. A "demand charge" is imposed upon all customers who are entitled by contract to receive a specified amount of natural gas from the pipeline. As the court of appeals explained, this charge "is not levied upon each unit of gas sold, but rather is a fixed sum, assessed in proportion to the maximum quantity of gas the customer is entitled to demand under the contract. The demand charge thus recoups some portion of the fixed costs incurred by the pipeline in providing a transmission mechanism of sufficient capacity to meet the customer's peak-load minimum entitlement." Pet. App. A19; see also *id.* at A71-A72.

The second component of pipelines' rates is the "commodity charge" levied upon each unit of gas sold. It is through this charge that a pipeline recovers its variable costs as well as the fixed costs that are not recovered through the demand charge. Pet. App. A18-A19; A72. Some pipelines include in their rate schedules a specific type of commodity charge known as a "minimum commodity bill." These minimum bill provisions essentially establish a minimum commodity charge, requiring the customer to pay for a certain quantity of gas even if the customer does not take delivery of any gas during the relevant time period. *Id.* at A19; A72-A73.

The Commission in the past has permitted pipelines to utilize minimum bill provisions because these provisions assist in the recovery of fixed costs. Minimum bill provisions typically are imposed upon a pipeline's "partial requirements" customers—those customers with access to more than one pipeline supplier.[2] Partial requirements customers can "swing from one source of supply to another." Pet. App. A75; see also *id.* at A19. If a partial requirements customer takes less gas from a pipeline than the pipeline expected to sell, and the pipeline is unable to sell the gas elsewhere, the revenue received by the pipeline pursuant to its commodity charge will be reduced and the pipeline may fail to recover its fixed costs.

Minimum bills guarantee a minimum payment by partial requirements customers; they provide protection against underrecovery of fixed costs and ensure that partial requirements customers bear an appropriate share of fixed costs. Minimum bills also pre-

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[2] "Full requirements" or "captive" customers are those who purchase their entire natural gas supply from one pipeline. Pet. App. A75.

vent pipelines from incurring the "take or pay" costs that can result when the pipeline's contract with its supplier provides that the pipeline will take a particular amount of gas or pay for that amount of gas. If the pipeline's sales decrease, the pipeline may not take the required quantity of gas and may be forced to make "take or pay" payments to its supplier. Since minimum bills discourage partial requirements customers from shifting suppliers, they assist pipelines in avoiding take or pay costs. Pet. App. A19-A20.

If the pipeline does incur take or pay costs, these costs generally may be included in the pipeline's rate base; the take or pay costs are treated as an investment upon which the pipeline may earn its prescribed rate of return. The typical take or pay contract provision then allows a pipeline five years to take delivery of the gas for which it has prepaid. If the pipeline fails to take delivery of the gas within the required period, it can recover prudently incurred take or pay costs. Pet. App. A20-A21; A78.

It is significant that the justifications for minimum bills traditionally focused upon the recovery of pipelines' fixed costs. As the Commission observed, "[t]he recovery of *variable* costs via minimum commodity bills [was] simply not an issue in the past. This is because interstate pipelines generally were buying all the gas they were offered * * * and because the major variable cost—the gas supply itself —represented a far smaller proportion of the minimum commodity bill than it does today." Pet. App. A79 (footnote omitted; emphasis in original); see also *id.* at A21.

b. In August 1983, the Commission issued a Notice of Proposed Rulemaking stating that it proposed

to eliminate minimum bills from pipelines' tariffs to the extent these provisions permitted the recovery of variable costs. The notice solicited comments from interested parties regarding the Commission's proposal. Pet. App. A22, A73-A74.

After considering comments from more than 90 parties, the Commission concluded that "collection of variable costs via a pipeline's minimum bill tariff provision is unjust and unreasonable under the Natural Gas Act" (Pet. App. A74). It promulgated a rule declaring "inoperative and of no effect at law" existing rate schedules and tariffs that provide for "recovery of purchased gas costs for gas not taken by the buyer"; the rule also bars the filing of new rate schedules or tariffs providing for "recovery of variable costs associated with gas not taken by the buyer" (*id.* at A123). Pipelines remain free to continue to utilize minimum bill provisions to recover their fixed costs.[3]

The Commission found that minimum bills had "become a vehicle by which enormous purchased

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[3] The Commission subsequently extended this rule to cover "minimum take" provisions, under which the customer is required to take physical delivery of a minimum quantity of gas and does not have the option of paying for gas not taken (see Pet. App. A231-A268). It concluded that "minimum take provisions operate to prevent purchasers from pursuing a least-cost purchasing strategy, thereby resulting in charges to customers in excess of the lowest reasonable rate consistent with reliable, long-term supply" (*id.* at A235) and found that minimum take provisions "share fully the market-distorting influences of the variable costs in minimum commodity bills" (*id.* at A236). The Commission therefore found that the same rule should apply to minimum take provisions, noting that a pipeline remained free to "seek recovery of fixed costs incurred as a result of a customer's failure" to meet its purchasing obligations (*ibid.*).

gas 'costs' can be collected even if the pipeline never actually incurs such costs" (Pet. App. A81). It stated (*id.* at A82):

> By definition, there are no variable costs incurred for volumes not purchased for resale. Accordingly, a minimum commodity bill that includes variable costs gives a pipeline the right to collect for "costs" it has not in fact paid out to provide jurisdictional natural gas service. On its face then, a minimum bill that permits such "cost" collection is unjust and unreasonable.

The Commission noted that the amounts of variable "costs" collected pursuant to minimum bills had increased dramatically as a result of the deregulation of natural gas prices: "gas prices have risen to the point that purchased gas costs make up the majority of a pipeline's variable costs and hence its commodity rate" (*id.* at A81). The elimination of variable costs from minimum bill provisions would prevent pipelines from reaping this financial windfall.

The Commission further found that minimum bills permitting recovery of variable costs had the effect of restraining competition, with the result that gas prices were " 'propped up' * * * at levels higher than the market would otherwise support" (Pet. App. A86 (footnote omitted)). A pipeline's "partial requirements customers cannot purchase lower cost gas supplies if they are required to pay for the higher-cost gas they do not take" (*id.* at A85). Minimum bill provisions thus insulate pipelines from market pressures: "[w]hen distributors and pipelines are required to purchase gas under a minimum commodity bill, even when less expensive sources are available, the supplier pipeline can continue to oper-

ate profitably without having to worry about keeping its gas costs at a reasonable level" (*id.* at A86).

Moreover, the Commission found that including variable costs in minimum bills "deprive[s] producers of the opportunity to increase sales volumes in exchange for accepting a reduction in price" (Pet. App. A87). This is because "[a] pipeline cannot offer to buy more gas from a producer that lowers its prices if that pipeline's customers are under minimum commodity bill obligations elsewhere" (*ibid.*); the pipeline would not be able to dispose of the larger quantity of gas because it would not be able to increase its own sales.

The Commission concluded that these significant adverse effects of permitting recovery of variable costs through minimum bill provisions outweighed any possible benefits of allowing such cost recovery. It first observed that the justifications traditionally advanced in support of minimum bill provisions concerned the recovery of fixed costs. This function was important when pipelines were making large investments in new facilities, but the Commission noted that "most pipelines are not in this situation" (Pet. App. A90). Many pipelines now use a rate approach that "permits recovery of more fixed costs in the demand charge and diminishes much of the formerly perceived need for minimum commodity bills" (*ibid.*). Moreover, pipelines using more traditional rate approaches still would be permitted to recover fixed costs through minimum bills; the rule bars only the inclusion of variable costs.

The Commission rejected claims that its new rule would adversely affect customers who rely upon a single pipeline as their only source of natural gas. The Commission noted that "viewed from a national

perspective, the rule may create offsetting benefits and detriments to captive customers, depending upon whether they are served by a high-cost or a low-cost pipeline" (Pet. App. A96-A97 (footnote omitted)). And customers of a high-cost pipeline would be protected from unwarranted rate increases through the Commission's regulation of pipeline rates under the Natural Gas Act (*id.* at A97-A100).

Finally, the Commission determined that pipelines should not be permitted to recover take or pay costs through minimum bills.[4] The Commission observed that a pipeline customer's decision to reduce its take of gas below minimum bill levels would not necessarily force the pipeline to incur take or pay costs. In addition, revenues from minimum bill provisions previously had not been viewed as compensating pipelines for take or pay costs; rather, "existing minimum commodity bills seem designed to prevent take-or-pay prepayments from being incurred in the first instance, by discouraging consumer cutbacks. This effect is * * * anti-competitive, unjust, and unreasonable." Pet. App. A103-A104.

Even if a pipeline did incur increased take or pay costs, "it is not clear that minimum commodity bills should force customers that cut back below minimum levels to compensate for the cost of any prepaid gas, since other customers may take that gas later" (Pet. App. A104). Requiring customers subject to minimum bills to absorb a pipeline's take or pay costs also would be inequitable, the Commission found, because

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[4] As discussed above (see page 5, *supra*), take or pay costs are costs incurred by a pipeline pursuant to a provision in the contract between the pipeline and its supplier requiring the pipeline to take delivery of a specified quantity of gas from the supplier or pay for that quantity of gas.

"full requirements customers not subject to a minimum commodity bill may be as much responsible for take-or-pay payments as swing customers who are subject to a minimum commodity bill" (*id.* at A105). If the pipeline "is permitted to 'cover' its take-or-pay costs via minimum bill charges, the customers subject to a minimum commodity bill will bear a disproportionate burden of the pipeline's take-or-pay obligations" (*ibid.*).[5]

2. The court of appeals unanimously affirmed the Commission's decision in virtually all respects (Pet. App. A1-A56).[6]

The court first addressed the Commission's statutory authority to issue the rule barring recovery of variable costs through minimum bill provisions. It stated that Section 5 of the Natural Gas Act, 15 U.S.C. 717d, empowers the Commission to fix "just and reasonable" rates and found that this authority, combined with the Commission's general rulemaking power (see 15 U.S.C. 717o), justified the issuance of the rule (Pet. App. A24-A25). The court also rejected several challenges to the Commission's statutory authority. First, it found that the elimination of variable costs from minimum bill provisions did

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[5] The Commission observed that the allocation of take or pay costs among pipeline customers might present special considerations warranting the allocation of such costs in a manner different from the allocation of other costs. It directed the Commission staff to study this question and address the issue in individual pipeline rate proceedings. Pet. App. A105-A107.

[6] The court remanded for further consideration the Commission's decision that downstream pipelines cannot recover through minimum bills certain fixed costs that their pipeline suppliers may include in minimum bills. Pet. App. A46-A50.

not constitute an impermissible revocation of the conditions of the certificates of public convenience and necessity issued to pipelines under Section 7 of the Natural Gas Act, 15 U.S.C. 717f. The court noted that certification of a pipeline's initial terms of service does not constitute a guarantee that those terms will not be changed pursuant to the Commission's authority to regulate rates under Section 5 (Pet. App. A25 n.9). Moreover, the court held, "elimination of minimum bills has no effect on the pipeline's *authorized* service. The Order merely addressed the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to section 5" (*ibid.* (emphasis in original)).

Second, the court rejected arguments that the rule impermissibly altered the terms of existing contracts, holding that "section 5 gives the Commission authority to alter terms of any existing contract found to be 'unjust' or 'unreasonable'" (Pet. App. A25-A26 n.9). Third, the court concluded that various settlement agreements in rate proceedings did not bar the Commission from adopting the rule; the court found that the rule did not conflict with the terms of the settlements (*id.* at A26-A29).[7]

On the merits, the court held that the Commission's decision to adopt the rule was supported by substantial evidence. The court identified (Pet. App. A33) "[t]hree essential findings" underlying the Commission's determination:

> First, minimum bills allow pipelines to recover for various costs that they do not incur. Second,

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[7] The court also held that the application of the rule to imported gas was not inconsistent with the Economic Regulatory Administration's authorization of the importation of that gas (Pet. App. A30-A31).

> minimum bills prevent gas purchasers from purchasing the lowest priced gas and hence artificially maintain high gas prices. Third, the benefit of eliminating variable cost recovery through minimum bills outweighs the negative impact such action will have upon pipelines and upon full requirements customers.

The court held that "the factual support for the overrecovery rationale is unassailable. Minimum bills allow [a] pipeline[] to charge for gas that its customer does not take; if the customer pays for gas not taken, the pipeline recovers for variable costs that it does not incur" (Pet. App. A33). The circumstance that a particular pipeline actually may not have overrecovered its costs did not undercut the Commission's conclusion, but "merely reflects the rational choice of its partial requirements customers to take gas that they must pay for rather than pay for gas not taken. The lynchpin [*sic*] of the Commission's rationale, however, is the *potential* for overrecovery" (*id.* at A33-A34 (emphasis in original)).

The court also upheld the Commission's determination that the record showed that minimum bills adversely affect competition. The court emphasized that the Commission's determination did not rest solely upon economic theory, observing that "[t]he record is replete with comments from customers who have been unable to purchase lower cost gas because of minimum bills and minimum take provisions" (Pet. App. A36 (footnote omitted)). The court concluded that "[e]ven if some customers do not pursue * * * [a least cost purchasing] strategy, the Commission has presented evidence that many customers will, and thus the elimination of minimum bills can reasonably be expected to lower gas costs and spur competition among pipelines" (*id.* at A37).

The court also upheld the Commission's determination that the benefits of eliminating variable costs from minimum bills outweighed any potential harms to pipelines and captive customers from that course of action. The court noted that "[t]he Commission gave considerable attention to the difficult take-or-pay issue" (Pet. App. A38). It agreed with the Commission that reductions in purchases by partial requirements customers would not necessarily result in take or pay liability and that pipelines could avoid take or pay costs by lowering prices to maintain sales. The court further noted that the increased price competition resulting from elimination of minimum bills "may spur renegotiation of take-or-pay clauses with gas producers" (*id.* at A39).

The court recognized "that many of the policy considerations that support the elimination of variable cost recovery for the minimum bill might support the elimination of take-or-pay clauses" (Pet. App. A39-A40), but it upheld the Commission's decision to take action only with respect to minimum bills. The court observed that the agency was not required to address all problems in a single rulemaking; rather, "[t]hat which we can require, the Commission has here provided: an explicit assessment of the relationship between the action taken and the issue deferred, and a reasonable conclusion that the public interest can best be advanced by the measured step taken" (*id.* at A40).

The court also determined that the Commission had adequately considered claims that pipelines' captive customers would bear increased costs if the pipelines lost sales (Pet. App. A41-A42). The court stated that "[h]ad the Commission either failed to address the problems faced by captive customers or

engaged in a less than candid balancing of the costs, its determinations perhaps would be vulnerable on review. The Commission, however, exhaustively considered these problems, recognized that some harm would result from the elimination of minimum bills, indicated it would consider in individual cases whether particular cost swings warrant special allotment of costs, and, finally, concluded that the benefit of increased competition would eventually inure to even the captive customer of a high-priced pipeline. These are the hard choices agencies are empowered—indeed required—to make" (*id.* at A41-A42).

Finally, the court affirmed the Commission's decision to address the minimum bill issue through a rulemaking proceeding rather than in pipeline-by-pipeline adjudications. It found that the "generalized nature of the problems addressed * * * did not require trial-type procedures appropriate for retrospective determination of specific facts about individual parties. Rather, notice and comment rulemaking * * * was a manifestly reasonable method of addressing the systemic problems of the natural gas market" (Pet. App. A52) (footnote omitted)).[8]

ARGUMENT

The thorough opinion of the court below, upon which we rely, is correct and does not conflict with any decision of this Court or another court of appeals. Further review by this Court is not warranted.

1. Petitioners present two challenges to the Commission's statutory authority to issue a rule prohibiting recovery of variable costs through minimum bills. First, petitioners argue (85-1219 Pet. 10-11; 85-1237

[8] The court also upheld the Commission's decision granting an exemption from the rule to one pipeline company (Pet. App. A43-A46).

Pet. 8-10) that the rule destroys the mutuality of obligation between pipelines and their customers. The court of appeals properly characterized this claim as "frivolous" (Pet. App. A25 n.9).

Section 5(a) of the Natural Gas Act, 15 U.S.C. 717d(a), expressly provides that "[w]henever" the Commission finds that "any rate [or] charge" or "contract affecting such rate [or] charge" is "unjust, unreasonable, unduly discriminatory, or preferential," the Commission shall determine the "just and reasonable rate, charge, * * * or contract to be thereafter observed and in force, and shall fix the same by order." As this Court has recognized, Section 5 confers upon the Commission "plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." *Permian Basin Area Rate Cases*, 390 U.S. 747, 783-784 (1968); see also *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 646-647 (1972). In *Permian Basin*, the Court upheld an order issued by the Federal Power Commission that barred the use of escalation clauses in existing contracts; the order in this case invalidating another sort of unreasonable contract provision therefore plainly falls within the Commission's statutory authority.[9]

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[9] Petitioners' references (85-1219 Pet. 8-10) to the role of contracts under the Natural Gas Act are irrelevant. Contract provisions cannot remain in effect when they contain terms found by the Commission to be unlawful under Section 5.

Petitioners observe (85-1219 Pet. 13-14) that the minimum bill provisions were approved by the Commission in earlier proceedings. This Court in *Permian Basin Area Rate Cases, supra*, recognized that such prior administrative action was immaterial; it declined to set the Federal Power Commission's order aside "merely because the Commission ha[d] on an earlier occasion reached another result; administrative author-

Moreover, petitioners' argument is completely insupportable in the present context because petitioners have not been deprived of the principal benefit of minimum bill provisions. Pipelines are barred only from recovering variable costs (principally the cost of purchased gas), and a pipeline will not incur this cost if the customer chooses not to purchase the gas. Thus, the minimum bill provision still fulfills its purpose of assisting pipelines in recovering their fixed costs; pipelines simply cannot recover variable costs for gas that they do not sell.[10]

Second, petitioners assert (85-1219 Pet. 22-25; 85-1252 Pet. 8-14) that the Commission lacks authority to issue the rule because the rule alters the terms of certificates of public convenience and necessity previously issued by the Commission pursuant to Section 7 of the Natural Gas Act, 15 U.S.C. 717f. Section 7 provides that a natural gas company must obtain a certificate of public convenience and necessity before it begins operations; the circumstance that a minimum bill provision was one of the terms and conditions of a pipeline's original certificate is simply irrelevant here. As the court of appeals observed, "elimination of minimum bills has no effect on the pipeline's *authorized* service. The [Commission's] Order merely addresses the *rates* the pipeline may

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ities must be permitted, consistently with the obligations of due process, to adapt their rules and policies to the demands of changing circumstances" (390 U.S. at 784).

[10] Petitioners argue (85-1219 Pet. 21-22) that they will be unable to recover take or pay costs but, as we discuss below (see pages 19-20), it is not clear that the rule regarding minimum bills will result in the imposition of take or pay costs upon pipelines and, in any event, recovery of these costs traditionally has not been a purpose of minimum bills.

charge its customers and therefore was properly issued pursuant to Section 5" (Pet. App. A25 n.9 (emphasis in original)).

Once a certificate of public convenience and necessity authorizing pipeline service is issued by the Commission, the pipeline becomes subject to the Commission's authority to set "just and reasonable" rates. The Commission is free to utilize its Section 5 rate regulating authority to alter the rates contained in the original certificate. See *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. at 643, 646-647 (Commission may use its Section 5 authority to regulate rates to release pipelines from their obligation to deliver certificated quantities of gas "whether or not it could also invoke § 7 for that purpose"); *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 392 (1959); *Pacific Gas Transmission Co.* v. *FPC*, 536 F.2d 393, 395-397 (D.C. Cir.), cert. denied, 429 U.S. 999 (1976). The Commission otherwise would be powerless to adjust the rate terms set forth in the original certificate. Indeed, the Commission itself concluded that Section 5 "*require*[*s*] the Commission to change terms and conditions under which a pipeline renders a certificated service if those terms and conditions result in rates and charges which are subsequently found unjust and unreasonable" (Pet. App. A135 (emphasis in original)).[11]

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[11] Petitioner Arkla Energy Resources claims (85-1252 Pet. 10-12) that the Commission may not use its Section 5 authority to prohibit minimum take provisions. However, the Commission's Section 5 authority extends to all terms and conditions of service affecting rates and charges; minimum take provisions plainly fall within this category. See page 6 note 3, *supra*.

Petitioner ANR Pipeline Co. asserts (85-1236 Pet. 14-16) that the Commission exceeded its statutory authority in prom-

2. Most of the arguments advanced by petitioners relate to the propriety of the Commission's policy determination. The court of appeals' thorough analysis of these issues (Pet. App. A32-A50) conclusively demonstrates that substantial evidence supports the Commission's decision to bar recovery of variable costs through minimum bills. This Court has stated repeatedly that the courts of appeals bear principal responsibility for determining whether an agency's decision is supported by substantial evidence; this Court will intervene only when the court of appeals has "misapprehended or grossly misapplied" the standard of review. *American Textile Manufacturers Institute* v. *Donovan*, 452 U.S. 490, 523 (1981); *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 309-310 (1974). Petitioners do not even come close to showing that the court of appeals committed such an error here.

Petitioners do not dispute that recovery of variable costs through minimum bills results in a windfall to

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ulgating the rule because the rule abrogates a rate proceeding settlement agreement to which the Commission was a party. The court of appeals correctly concluded (Pet. App. A27-A29) that the rule did not abrogate the settlement agreement. The settlement agreement "merely defers resolution of the minimum bill issue" (*id.* at A29) and expressly states that "no party waives any rights with respect to the substantive standards for decision which should be applied herein" (85-1236 Pet. B1-B2). Thus, the settlement did not exclude the issue from the general rulemaking proceeding (Pet. App. A29).

Moreover, the Commission surely was correct in concluding (Pet. App. A110) that it may utilize its Section 5 rate regulating authority to alter a provision of a settlement agreement. Otherwise, the Commission could be bound forever by a settlement, regardless of how unjust or unreasonable the terms of the settlement had become.

a pipeline because the pipeline has not sold any gas and therefore has not incurred any variable costs. Several petitioners do assert that the Commission erred in concluding that the provisions are anticompetitive (85-1219 Pet. 18-20) or that the Commission should not have considered competition in its analysis (85-1237 Pet. 7; 85-1250 Pet. 10-15). But the Commission surely did not err in concluding that the effect of minimum bill provisions upon competition is a factor that may be considered in assessing the reasonableness of the provisions under Section 5. Congress itself has placed great emphasis upon encouraging reliance upon market forces in the natural gas industry. See *Transcontinental Gas Pipe Line Corp.* v. *State Oil and Gas Board*, No. 84-1076 (Jan. 22, 1986), slip op. 11. And petitioners have not presented evidence contradicting the Commission's careful analysis of the competitive effect of these provisions. See Pet. App. A34-A37, A85-A92; see also pages 7-8, *supra*.

Petitioners' basic argument (85-1219 Pet. 21-22; 85-1236 Pet. 9-14; 85-1237 Pet. 14-15; 85-1250 Pet. 15-19) is that pipelines will be harmed financially by the Commission's rule because they will be required to bear take or pay costs. But the Commission and the court of appeals agreed that the elimination of variable costs from minimum bills would not necessarily result in the imposition of take or pay liability upon pipelines. The Commission summarized its conclusions as follows:

> [C]ustomer cutbacks below minimum bill levels may not cause *any* take-or-pay costs. Second, even if take-or-pay payments do result from such cutbacks, existing minimum commodity bills generaly [*sic*] do not serve to compensate for the

> cost of the take-or pay gas, and thus do not protect a pipeline's remaining customers from any resulting rate increases. Third, it is not clear that minimum commodity bills should force customers that cut back below minimum levels to compensate for the cost of any prepaid gas, since other customers may take that gas later.

Pet. App. A104 (emphasis in original); see also *id.* at A39.

Petitioners argue that the new rule will affect their "very viability as * * * continuing entit[ies]" (85-1250 Pet. 17) and that they have been placed in "a contractual vise" (85-1237 Pet. 14), but these assertions were for the Commission to evaluate. As the Commission and the court of appeals observed, pipelines might be able to sell the requisite quantity of gas by lowering prices, or they might be able to eliminate or reduce their take or pay obligations through renegotiation with gas producers. Pet. App. A39, A172, A182-A183. Moreover, a pipeline that does incur take or pay costs generally may include those costs in its rate base and, if necessary, can recover prudently incurred take or pay costs from its customers (see page 5, *supra*). Thus, a variety of methods are available to pipelines to ameliorate potential take or pay liability.[12]

3. Petitioners also contend (85-1219 Pet. 12-17; 85-1237 Pet. 10-13) that the Commission erred be-

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[12] Petitioners state in conclusory terms that the rule adopted by the Commission will increase costs for captive customers of pipelines (85-1236 Pet. 8, 10), but they present no evidence contradicting the Commission's conclusion that such customers will benefit in the long term from the elimination of variable costs from minimum bills and can be protected in the interim from improper rate increases (Pet. App. A95-A100).

cause it implemented its new policy regarding minimum bills by issuing a rule rather than undertaking individual pipeline-by-pipeline adjudications. These claims are without merit.

The Commission plainly has statutory authority to set rates and charges by rulemaking rather than adjudication. Section 5(a) of the Natural Gas Act, 15 U.S.C. 717d(a), states that the Commission may establish just and reasonable rates "after a hearing," but the provision has not been construed to require a formal evidentiary hearing in every case. *Tenneco Oil Co.* v. *FERC*, 571 F.2d 834, 840-841 (5th Cir.), cert. dismissed, 439 U.S. 801 (1978); *American Public Gas Association* v. *FPC*, 567 F.2d 1016, 1064-1067 (D.C. Cir. 1977), cert. denied, 435 U.S. 907 (1978); *Phillips Petroleum Co.* v. *FPC*, 475 F.2d 842, 848-851 (10th Cir. 1973), cert. denied, 414 U.S. 1146 (1974); see also *United States* v. *Florida East Coast Ry.*, 410 U.S. 224, 241 (1973) (statutory requirement of a hearing satisfied by written comments). Moreover, Section 403(c) of the Department of Energy Organization Act, 42 U.S.C. 7173(c), provides that "[a]ny function * * * which relates to the establishment of rates and charges under the * * * Natural Gas Act * * * may be conducted by rulemaking procedures." Since the present proceeding obviously relates to "rates and charges," Section 403(c) authorized the Commission to proceed by rulemaking.

Petitioners surely are incorrect in asserting (85-1219 Pet. 15-17) that because the Commission's ratemaking decisions are reviewed under the "substantial evidence" standard (see 15 U.S.C. 717r(b)), the Commission may only set rates through adjudicatory proceedings. The standard of review applicable to an administrative decision does not affect the proce-

dure that the agency must follow in reaching that decision. Pet. App. A54-A55; *American Public Gas Association* v. *FPC*, 567 F.2d at 1067; see also *United States* v. *Florida East Coast Ry., supra.* Indeed, a contrary conclusion would conflict directly with this Court's determination in *Vermont Yankee Nuclear Power Corporation* v. *NRDC*, 435 U.S. 519 (1978), that a court may not "overturn [a] rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the [Nuclear Regulatory] Commission so long as the Commission employed at least the statutory *minima*" (435 U.S. at 548).[13]

In view of the Commission's statutory authority to proceed by rulemaking, its decision to select that course of action plainly is not subject to challenge. See *SEC* v. *Chenery Corp.*, 332 U.S. 194, 203 (1947) ("the choice made between proceeding by general rule or by individual ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency"). The court of appeals correctly concluded that "[t]he generalized nature of the problems addressed * * * did not require trial-type procedures appropriate for retrospective determination of specific facts about individual parties. Rather, notice and comment rulemaking * * * was a manifestly reasonable method of addressing the sys-

[13] Petitioners contend that the rule set forth by this Court in *Vermont Yankee* is not applicable here because the present proceeding involves "fact-specific findings affecting a limited number of companies" (85-1219 Pet. 17). Petitioners' assertion is incorrect. The type of costs that may be recovered through minimum bills is a general issue affecting all natural gas pipelines that involves industry-wide questions; it therefore properly was addressed by the Commission through a rulemaking proceeding. See Pet. App. A52.

temic problems of the natural gas market" (Pet. App. A52 (footnote omitted)).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

CHARLES FRIED
Solicitor General

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

A. KAREN HILL
Attorney
Federal Energy Regulatory Commission

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No. 85-1250

IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

TRUNKLINE GAS COMPANY

and

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF OF PETITIONERS TRUNKLINE GAS COMPANY AND PANHANDLE EASTERN PIPE LINE COMPANY

RAYMOND N. SHIBLEY *
PATRICK J. WHITTLE
LEBOEUF, LAMB, LEIBY & MACRAE
1333 New Hampshire Ave., N.W.
Washington, D.C. 20036
(202) 457-7500
Attorneys for Petitioners

* Counsel of Record

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REPLY BRIEF OF PETITIONERS TRUNKLINE GAS COMPANY AND PANHANDLE EASTERN PIPE LINE COMPANY

Trunkline Gas Company (Trunkline) and Panhandle Eastern Pipe Line Company (Panhandle) hereby submit their reply brief in the above-captioned action.

The Brief for the Federal Energy Regulatory Commission (Commission) in Opposition to Trunkline's and

Panhandle's petition for certiorari (hereinafter cited as "Commission Brief"), combining its response to the petitions for certiorari of several pipeline companies, seeks to defend the orders of the Commission below on grounds that they were a simple "policy determination" (*e.g.*, Commission Brief at 18) and that the Court of Appeals correctly held that "substantial evidence supports the Commission's decision to bar recovery of variable costs through minimum bills." *Id.* In support, respondents offer three "essential findings"—actually only two separate factual conclusions [1]—which, they allege, were supported by substantial evidence. *Id.* at 11-12. Because the Court of Appeals has held that such substantial evidence existed in the record, they assert, this Court should not intercede by grant of certiorari. *Id.* at 18.

But contrary to respondents' assertions, Trunkline's and Panhandle's petition was not merely a disagreement as to the factual findings and policy determinations of the Commission. Instead, it was based on the insufficiency of the factual findings, supported or not, to overcome the central illegality of the Commission's action under the Natural Gas Act (NGA), 15 U.S.C. §§ 717-717w, and the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432. The "essential findings" relied on in the analyses of the Court of Appeals and the Commission do not ameliorate this illegality, they aggravate it.

First, the Commission Brief once again (at 11-12) revives the assertion that the elimination of variable costs from pipeline minimum commodity bills would operate to prevent windfall recoveries by pipelines of variable costs, including purchased gas costs, for gas which

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[1] The third "essential finding," cited by the Court of Appeals and the Commission Brief, is merely duplicative, asserting only that the purported negative impact of the first two "essential findings" outweighs any benefits that could accrue from retaining minimum bills. Commission Brief at 11-12.

their customers do not take. Because of the continued repetition of and reliance on this point, it becomes necessary to emphasize, as we have done at all levels, that there is no record evidence whatever that any of the contract or tariff provisions ever operated to produce that result, or that a penny of such "windfall" has ever been pocketed by any pipeline. The argument is a straw man because the partial requirements customers have always taken at least their minimum bill levels and they do not pay for gas not taken.[2] This fact is not surprising. It reflects only that minimum bills have worked as they are intended to—to contractually commit pipelines' customers to purchase specified minimum amounts of gas for the long-term.

The Commission and its supporters, however, attempt to turn this virtue into a vice. They seek to avoid the obvious fact that if the volumetric level of the customer's obligation is too high, that level may be reduced in appropriate Commission proceedings. The NGA, in Sections 5 and 7 (15 U.S.C. §§ 717d, 717f), provides specific procedures for effecting such a reduction in quantity. These procedures reduce both the obligation of the pipeline to provide the gas and the obligation of the customer to receive or pay for a percentage of the certificated volumes. The statutory scheme makes these obligations *mutual*, not unilateral as the Commission has ordered. It is

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[2] Neither the Commission nor the Court of Appeals cited any record evidence of the permanent collection by a pipeline of amounts representing costs not incurred. (In the sole reference by the Commission on this issue, it cited only an instance in which such costs had been collected *and later refunded*; *see* Pet. App. at A-183.) Instead, as admitted in the Commission's Brief at 12, both the Commission and the Court of Appeals simply held that it *did not matter* whether such costs were ever recovered in fact so long as the "potential" for such recovery existed. *See, e.g.*, Pet. App. at A-33. But so long as minimum bills work as intended—to set minimum purchase commitments for pipeline customers—no such potential for overrecovery actually exists.

neither necessary nor appropriate under this statutory scheme to eliminate the payment obligation of the customer while maintaining the pipeline's supply obligation.

In the second of the "essential findings" cited in the Commission Brief (at 12), the Commission asserted that by successfully requiring a pipeline's customers to take a minimum amount of gas, minimum bill clauses are "anti-competitive" because they prevent customers from purchasing that same gas from the pipeline's competitors. This simple truism, however, provides no support for the Commission's action. The Commission's characterization of these long-standing contract provisions as "anticompetitive" is patently illogical, because it applies with equal force to any purchase contract whatever. As this Court has so pertinently stated:

> [T]he legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence.

Board of Trade of Chicago v. United States, 246 U.S. 231, 238 (1918).[3] The Commission's analysis, based as it is on these two "essential findings," is therefore arbitrary on its face.

More fundamentally still, the Commission's reasoning is fatally inconsistent with the structure of the natural gas pipeline industry established in the Natural Gas Act and fortified by years of agency and court precedent. As this Court stated definitively in *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 659-60 (1964), the pipeline industry is sustainable *only* by the establishment of long-term contracts between pipelines and their custom-

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[3] Indeed, minimum commodity bills restrain competition *less* than typical purchase contracts, since they only commit customers to purchase a specified percentage (*e.g.* 75 percent) of their contract quantities of gas.

ers, which make possible the massive investments required to construct pipelines and establish service. The NGA recognizes this structure by requiring certification of core market sales contracts, thereby removing them from the competitive arena. *Id.* Forcing pipelines to engage in day-to-day competition to retain their core sales markets is inconsistent with this NGA-mandated industry structure. *Id.* The Commission may not, therefore, impose mandatory, day-to-day competition for core markets; its competitive concerns are to be directed toward maintaining the opportunity for competition for uncommitted or incremental sales in expanding markets, as discussed in the *El Paso* case. *Id.*

It is no answer, as the Commission Brief suggests (at 16), that the Commission still permits the recovery of fixed costs in minimum bills, thus covering the cost of pipeline facilities themselves.[4] Huge investments are equally necessary—in the form of take-or-pay and other contractual commitments—for pipelines to establish the long-term supply sources which are vital to their ability to satisfy their own utility obligations, to which they remain committed even though the Commission is releasing the customer from the obligation to purchase. *See, e.g., Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board,* 106 S. Ct. 709, 712 (1986); *United Gas Pipe Line Co. v. FERC,* 597 F.2d 531, 588 (5th Cir. 1979), *cert. denied,* 445 U.S. 916 (1980).[5] The fostering

[4] Even this rationale is no longer factually supported. In a recent rate case involving Transwestern Pipeline Co. the Commission rejected even a fixed-cost minimum bill, replacing it with a rate design which *denied* assurance of recovery of large portions of fixed costs, including any return on the equity investments made in pipeline facilities. *See Transwestern Pipeline Co.,* 32 FERC (CCH) ¶ 61,009 at 61,031-32 (1985).

[5] The Commission (and its predecessor Federal Power Commission) has long required, for example, that pipelines seeking authorization to construct major new facilities or provide a new

of such stable long-term supply relationships is a keystone of regulation under both the NGA and the NGPA—for the fundamental goal of both is to "assure *adequate supplies* of gas at reasonable prices." *Transcontinental Gas Pipe Line Corp.*, 106 S. Ct. at 716 (emphasis added). Plainly, in order to permit the obtaining of such supplies, pipelines must be able to receive commitments from customers to purchase minimum amounts of the gas obtained—and this is precisely what variable-cost minimum commodity bills accomplish.

Eviscerating pipelines' sales contracts, by effectively removing the customers' obligations to purchase, is an attempt to comprehensively restructure the supply relationships of the industry, in a manner which is not permitted by the NGA or the NGPA. Moreover, the Commission embarks on such restructuring in the name of promoting competition for pipelines' *core* markets, forcing pipelines into "a continuous daily struggle to hold old customers and to win new ones over from their rivals"—a type of competition which this Court has specifically recognized to be beyond the purview of the NGA. *El Paso Natural Gas Co.*, 376 U.S. at 659-60. The Commission has no authority—under Section 5 of the NGA (15 U.S.C. § 717d), Section 7 of the NGA (15 U.S.C. § 717f) or any other statutory provision—to adopt a rule so directly at odds with the market structure established by its governing statute.

Neither the Commission nor the Court of Appeals has begun to address, much less to rectify, this fundamental

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service must make a showing that adequate gas supplies are under contract to support the facilities' construction or the service's offering. *See, e.g., Public Service Commission v. FPC*, 437 F.2d 1234, 1237 (4th Cir. 1971); 18 C.F.R. § 2.61(c) (1985). Indeed, Congress expressly contemplated such a requirement. *See* H.R. Rep. No. 1290, 77th Cong., 1st Sess. 2-3 (1941).

invalidity of the orders under the NGA and NGPA. This basic defect, and the massive rearrangement of the entire gas pipeline industry which results, plainly justify the grant of certiorari in this case.

Respectfully submitted,

RAYMOND N. SHIBLEY *
PATRICK J. WHITTLE
LEBOEUF, LAMB, LEIBY & MACRAE
1333 New Hampshire Ave., N.W.
Washington, D.C. 20036
(202) 457-7500
Attorneys for Trunkline Gas Company and Panhandle Eastern Pipe Line Company

* Counsel of Record

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